EXTRACT FROM BY-LAWS

Section 9. No book shall, at any time, be taken from the Library Room to any other place than to some court room of a Court of Record, State or Federal, in the City of San Francisco, or to the Chambers of a Judge of such Court of Record, and then only upon the accountable receipt of some person entitled to the use of the Library. Every such book so taken from the Library, shall be returned on the same day, and in default of such return the party taking the same shall be suspended from all use and privileges of the Library until the return of the book or full compensation is made therefor to the satisfaction of the Trustees.

Sec. 11. No books shall have the leaves folded down, or be marked, dog-eared, or otherwise soiled, defaced or injured. Any party violating this provision, shall be liable to pay a sum not exceeding the value of the book, or to replace the volume by a new one, at the discretion of the Trustees or Executive Committee, and shall be liable to be suspended from all use of the Library till any order of the Trustees or Executive Committee in the premises shall be fully complied with to the satisfaction of such Trustees or Executive Committee.

WILCOX & CO

[illegible]

No. 10228

United States
Circuit Court of Appeals
For the Ninth Circuit.

Vol
2327

WASHMONT CORPORATION, a Corporation,

Appellant,

vs.

THOR W. HENRICKSEN, Individually, and as Acting Collector of Internal Revenue for the Western District of Washington, Southern Division,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States for the Western District of Washington, Southern Division

ROTARY COLORPRINT, 590 FOLSOM ST., SAN FRANCISCO

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

Index Page

ATTORNEYS OF RECORD

JONES & BRONSON, and

H. B. JONES,

Coleman Building, Seattle, Washington

Attorneys for Plaintiff-Appellants.

J. CHARLES DENNIS, United States Attorney, and

HARRY SAGER, Asistant United States Attorney,

324 Federal Building, Tacoma, Washington

THOMAS R. WINTER, General Counsel Representative of Bureau of Internal Revenue,

901 Federal Office Building, Seattle, Washington

Attorneys for Defendant-Appellee.

In the District Court of the United States for the Western District of Washington, Southern Division

No. 216

WASHMONT CORPORATION, a corporation,
Plaintiff,

vs.

THOR W. HENRICKSEN, individually and as Acting Collector of Internal Revenue for the Western District of Washington, Southern Division,
Defendant.

COMPLAINT

Comes now the plaintiff and for cause of action against the defendant herein alleges as follows:

I.

That the defendant herein is and ever since prior to the 8th day of July, 1940, has been the Acting Collector of Internal Revenue for the Collection District of Washington, having his office and residing at the City of Tacoma within the jurisdiction of this court; that the acts done by the defendant as herein alleged were done by him in his representative capacity and under and pursuant to the directions of the Commissioner of Internal Revenue of the United States.

II.

That the plaintiff is and at all times herein men-

tion was a corporation organized and existing under the laws of the State of Washington and having its principal place of business at the City of Seattle, King County therein, and making its returns under the Federal income and excess-profits acts to the Collector of Internal Revenue at Tacoma, Washington; that the plaintiff has at all times borne true faith and allegiance to the government of the United States and has not in any way aided, abetted or given [1*] encouragement or comfort to any person, persons or government in rebellion against the United States, nor has it aided, abetted or given encouragement to any sovereign or government which has been or is at war with the United States.

III.

That pursuant to the requirements of the Federal income and excess-profits tax laws (now Internal Revenue Code) then in force and effect, the plaintiff duly filed its income tax returns with the defendant for the taxable years 1937 and 1938 as an ordinary corporation, and within due time paid to the defendant all tax liability arising thereunder.

IV.

That thereafter the Commissioner of Internal Revenue caused an audit to be made of said returns as a result of which he held and determined that during each of said years the plaintiff constituted a personal holding company and was subject to tax as such under and pursuant to provisions of Section

*Page numbering appearing at foot of page of original certified Transcript of Record.

351 of the Revenue Act of 1936, as amended by the Revenue Act of 1937 and Section 401 of the Revenue Act of 1938, the provisions of which acts, with reference to the matter here in controversy, are substantially identical. The Commissioner of Internal Revenue further held that the plaintiff was required to file and was delinquent by reason of not filing a return as a personal holding company on Form 1120-H for each of said years. Thereupon and by reason of such holding and determination the Commissioner of Internal Revenue held that this plaintiff was subject to assessment for and he did thereupon determine and assess a deficiency in income taxes under the personal holding company sections of the applicable revenue acts in the sum of $2,759.71, together with a penalty for failure to file a personal holding company return of $685.55, making a total of $3,445.26 for the year 1937 and of [2] $2,097.16, together with a penalty for failure to file a personal holding company return of $582.88, making a total of $2,680.04 for the year 1938.

V.

That thereafter and pursuant to such determination of the Commissioner of Internal Revenue and on or about July 8, 1940, the plaintiff paid to the defendant, as Acting Collector of Internal Revenue for the Collection District of Tacoma, the sum of $6,815.32, being the amount of said deficiencies and interest thereon as above set forth, together with interest applicable to the deficiency for 1937

amounting to $478.56 and for the year 1938 amounting to $211.46.

That thereafter and on or about July 19, 1940, plaintiff filed with the defendant, as Acting Collector of Internal Revenue for the Collection District of Tacoma, claims for refund of said payment of deficiencies and interest amounting to the said sum of $6,815.32, and that full, true and correct copies of such claims are hereto attached, marked Exhibits A and B, and by this reference made a part hereof.

VI.

That thereafter under date of December 13, 1940, the Commissioner of Internal Revenue notified the plaintiff of the rejection of such claims in their entirety and that copy of such notice is hereto attached, marked Exhibit C, and by this reference made a part hereof; that in spite of such notice of total rejection of claims there has been refunded to the plaintiff the sum of $121.34 determined as an overpayment of interest on the assessments above mentioned and which is properly to be credited in reduction thereof.

VII.

That at no time during the last half of the taxable years [3] 1937 and 1938 was 50% in value or more of the outstanding stock of the plaintiff held either directly or indirectly by or for not more than five individuals and that plaintiff was not a personal holding company nor was it subject to tax as a personal holding company nor to the filing

of a personal holding company return for either of said years, and that the entire amount of payments above set forth were unjustly and unlawfully demanded and collected of and from the plaintiff; that by reason thereof plaintiff is entitled to recover from the defendant the said sum of $6,815.32, less credit for the said sum of $121.34, making a total amount due the plaintiff from the said defendant $6,693.98, together with interest thereon from the 8th day of July, 1940.

Wherefore, plaintiff prays for jugdment against the defendant in the sum of $6,693.98, together with 6% interest thereon from the 8th day of July, 1940, together with its costs and disbursements herein.

JONES & BRONSON

(Signed) H. B. JONES

Attorneys for Plaintiff

[Endorsed]: Filed Feb. 19, 1941. [4]

EXHIBIT "A"

CLAIM

Form 843

Treasury Department
Internal Revenue Service
(Revised April 1940)

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

Collector's Stamp—(Date received)

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

[ ] Refund of Tax Illegally Collected.

[ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

[ ] Abatement of Tax Assessed (not applicable to estate or income taxes).

State of Washington
County of King—ss:

Type or Print

Name of taxpayer or purchaser of stamps—Washmont Corporation.

Business address—Marion Building, Seattle, Washington

Residence....................

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed—Tacoma

2. Period (if for income tax, make separate form for each taxable year) from 1-1-37, 19.., to 12-31-37, 19..

3. Character of assessment or tax—Income taxes

4. Amount of assessment, $2,759.71 prin, 685.55 penalty, 478.56 int. on July 8, 1940.

5. Date stamps were purchased from the Government ——

6. Amount to be refunded—$3,923.82

7. Amount to be abated (not applicable to income or estate taxes)—$......

8. The time within which this claim may be legally filed expires, under Section 322(b) IRC of the Revenue Act of 19...., on July 8, 1942.

The deponent verily believes that this claim should be allowed foı the following reasons:

The additional assessment results from holding that the taxpayer was a personal holding company subject to taxation under Section 351 (a) of the Revenue Act of 1936 and to a penalty for failure to file a personal holding company return. In reaching such conclusion the Commissioner has disregarded the status of certain participating dividend debentures of the taxpayer company amounting to $625,000.00 and held the same to constitute indebtedness of the company and not a stock or equity interest. Such debentures, however, were in fact and in law not part of the general indebtedness of the taxpayer company but represented a stock or share holding interest therein subject and subordinate, both currently and upon liquidation, to the general indebtedness of the company and representing capital at risk in the conduct of taxpayer's business. Said debentures were, during the taxable period, owned and held by a corporation. At no time during the taxable year was 50% in value of the outstanding stock of the taxpayer, including such participating dividend debentures,

owned, either directly or indirectly, by or for more than five individuals.

(Signed) WASHMONT CORPORATION

By ——————

Sworn to and subscribed before me this 18th day of July, 1940.

............................., Notary Public.

(Signature of officer administering oath)

(See Instructions on Reverse Side) [5]

CERTIFICATE

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax: (Show, in the ninth column, by symbols "Pd.," "Ab.," or "Cr.," the nature of each entry in the eighth column.)

Claim No.................................

Class of tax and taxable year or period.

Assessment List. List—Month—Year.

Account No. or Page, Line.

Amount assessed $......... Total, $.........

Paid, Abated, or Credited. Date—Amount, $.... Total, $...........

I certify that the records of this office show the following facts as to the purchase of stamps:

To Whom Sold or Issued—Kind—Number—Denomination—Date of sale or issue—Amount $......

If special tax stamp, state: Serial number—Period commencing—.

...., ...

Collector of Internal Revenue. (District)

Claim examined by—

Claim approved by—

Chief of Division.

Amount claimed...... $....................

Amount allowed...... $....................

Amount rejected...... $....................

Committee on Claims

....

....

....

Instructions

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or

other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

EXHIBIT "B"

CLAIM

Form 843

Treasury Department
Internal Revenue Service
(Revised April 1940)

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

Collector's Stamp—(Date received)

The Collector will indicate in the block below the kind of claim filed. and fill in the certificate on the reverse side.

[ ] Refund of Tax Illegally Collected.

[ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

[ ] Abatement of Tax Assessed (not applicable to estate or income taxes).

State of Washington
County of King—ss:

Type or Print.

Name of taxpayer or purchaser of stamps—Washmont Corporation.

Business address—Marion Building, Seattle, Washington.

Residence..

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed—Tacoma.

2. Period (if for income tax, make separate form for each taxable year) from 1-1-38, *19*........, to 12-31-38, *19* .

3. Character of assessment or tax—Income taxes.

4. Amount of assessment, $2,097.16 prin, 582.88 penalty, 211.46 int. on July 8, 1940.

5. Date stamps were purchased from the Government——

6. Amount to be refunded—2,891.50 $2,891.50

7. Amount to be abated (not applicable to income or estate taxes) $................

8. The time within which this claim may be legally filed expires, under Section 322(b) IRC of the Revenue Act of 19......, on July 8, 1942.

The deponent verily believes that this claim should be allowed for the following reasons:

The additional assessment results from holding that the taxpayer was a personal holding company subject to taxation under Section 401 of the Revenue Act of 1938 and to a penalty for failure to file a personal holding company return. In reaching such conclusion the Commissioner has disregarded the status of certain participating dividend debentures of the taxpayer company amounting to $625,000.00 and held the same to constitute indebtedness of the company and not a stock or equity interest. Such debentures, however, were in fact and in law not part of the general indebtedness of the taxpayer company but represented a stock or share holding interest therein subject and subordinate, both currently and upon liquidation, to the general indebtedness of the company and representing capital at risk in the conduct of taxpayer's business. Said debentures were, during the taxable period, owned and held by a corporation. At no time during the taxable year was 50% in value of the outstanding stock of the taxpayer, including such participating dividend debentures, owned, either directly or indirectly, by or for more than five individuals.

(Signed) WASHMONT CORPORATION

By ....

Sworn to and subscribed before me this 18th day of July, 1940.

...., Notary Public

(Signature of officer administering oath) (Title)

(See Instructions on Reverse Side) [6]

CERTIFICATE

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax: (Show, in the ninth column, by symbols "Pd.," "Ab.," or "Cr.," the nature of each entry in the eighth column.)

Claim No........................

Class of tax and taxable year or period.

Assessment List—List—Month—Year.

Account No. or Page, Line.

Amount assessed $............... Total, $................

Paid, Abated, or Credited—

Date—Amount $................ Total, $................

I certify that the records of this office show the following facts as to the purchase of stamps:

To Whom Sold or Issued—Kind—Number—Denomination—Date of sale or issue—Amount $............

If special tax stamp, state: Serial number—Period commencing—.

...., ...

Collector of Internal Revenue. (District)

Claim examined by—

Claim approved by—

Chief of Division.

Amount claimed...... $.....................

Amount allowed...... $.....................

Amount rejected...... $.....................

Committee on Claims

....

....

....

Instructions

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, fol-

lowed by the signature and title of the officer having authority to sign for the corporation.

EXHIBIT "C"

TREASURY DEPARTMENT
Washington

Dec. 13, 1940

IT:Cl:CC:4-CCP

Washmont Corporation,
Marion Building
Seattle, Washington

In re: Claims for refund of $3,923.82 and $2,-891.50

Sirs: For the years 1937 and 1938

Reference is made to the revenue agent's report upon an investigation of your tax liability dated Oct. 30, 1940, a copy of which was forwarded you, wherein you were informed that the claims for refund indicated above will be disallowed.

In accordance with the provisions of existing internal revenue law, notice is hereby given of the disallowance of your claims in full.

Respectfully,
GUY T. HELVERING,
Commissioner.
By J. MOONEY,
Deputy Commissioner.

724M

[Endorsed]: Filed Feb. 19, 1941. [7]

[Title of District Court and Cause.]

AMENDED ANSWER

Comes now the defendant above named by and through his counsel, J. Charles Dennis, United States Attorney for the Western District of Washington, Harry Sager, Assistant United States Attorney for said District, and Thomas R. Winter, General Counsel Representative, Bureau of Internal Revenue, and for his Amended Answer to the Complaint of the plaintiff herein, admits, denies and alleges as follows, to-wit:

I.

Defendant admits the allegations contained in paragraphs I, II, III, IV, V and VI of plaintiff's complaint.

II.

Answering paragraph VII of plaintiff's complaint, defendant denies the same and the whole thereof.

Further answering said complaint, and by way of Further and Alternative Defense thereto, defendant alleges:

I.

In the event the Court should find that the plaintiff herein during the years 1937 and 1938 was not a personal holding corporation within the meaning of such term as [8] provided by statute, but was an ordinary corporation and was taxable as such, then the defendant alleges that even in such event the

plaintiff underpaid its tax liability by reason of the following facts:

(1) That for the year 1937, plaintiff in the computation of its net income deducted from its gross income $50,000.00 as interest on indebtedness, and for the year 1938, it deducted $31,250.00 as interest on indebtedness; that such deductions were allowed by the Commissioner of Internal Revenue in his determination of the tax liability of plaintiff for said years upon the theory that the debenture certificates involved in this action were debts of the plaintiff and were not shares of its capital stock.

(2) That if it should be determined in this cause that the said debenture certificates are shares of stock of the plaintiff corporation, that then the deduction of the aforesaid sums of $50,000.00 and $31,250.00, was a wrongful deduction from the gross income of the plaintiff, and the amount of plaintiff's recovery herein should be reduced by the income and excess profits tax attributable to such wrongful deductions.

Wherefore, having fully answered the plaintiff's complaint herein, defendant prays that the plaintiff take nothing by this action and that the said complaint be dismissed without cost to defendant herein. In the alternative, defendant prays that in the event the Court shall determine the plaintiff is entitled to recover under the prayer of its complaint herein, that the amount of recovery be reduced by the income and excess profits tax [9] attributable to the wrongful deduction for the years 1937 and

1938 of the amounts of $50,000.00 and $31,250.00 respectively.

J. CHARLES DENNIS
United States Attorney.
HARRY SAGER
Assistant United States Attorney.
THOMAS R. WINTER
General Counsel Representative, Bureau of Internal Revenue.
Attorneys for Defendant.

[Endorsed]: Filed Oct. 22, 1941. [10]

[Title of District Court and Cause.]

MEMORANDUM DECISION

The Court: This in all respects takes the place of the Court's oral decision as announced from the bench January 15, 1942, and said oral decision as then announced is hereby stricken and further held for naught.

The decision of the Court will not be based upon the fact that the issuance of the debenture certificates involved in this case may not have been in accordance with the State law governing the issuance of corporate capital stock. The Court will lay aside any consideration of that point.

Likewise, the Court's decision will not be based upon the contention made by defendant's counsel

that, because of the rule relating to options to purchase or acquire stock, the taxpayer corporation was in legal effect the owner of the debentures by virtue of the redemption accelerating provision of the debenture certificate.

We have here a question of whether a certain written instrument (the debenture certificate) is of the nature of an indebtedness against the corporation issuing it, or [11] whether it is of the nature of a stockholder's interest in the corporation.

There is no question but that the dominant intention of the incorporators was to prevent this instrument from being what we ordinarily understand as a legal stockholder's certificate, that is, an instrument making the holder a stockholder legally entitled to participate in the corporate affairs of the corporation issuing this certificate. The dominant purpose was to prevent that.

In order to induce the prospective certificate holder to be satisfied with its nature, whatever its nature was, and to be satisfied to give up the voice that a legal stockholder might have in the corporation, the certificate, among other provisions, did make the certificate holder entitled to a guaranteed interest rate,—the very small rate of 3%,—and also gave the certificate holder the right to participate in any distribution of assets, or in something over and above the face value of the certificate and accrued interest and participating benefits, in the nature of an accelerated distribution right in the corporate assets, along with the stockholders, in case the de-

benture should be called for redemption prior to normal redemption.

But the written terms of the certificate, in stating the obligations of the corporation, are more of the nature of indebtedness than they are of the nature of shares of stock. This is in the certificate manifested by an acknowledgment of the corporation's indebtedness and by an absolute promise to pay the face value of the certificate (and interest and participating benefits, to be conditionally paid) and by a provision giving the certificate holder a [12] lien on all the corporation's property, present and future, to secure the payment of its obligations under the certificate.

The validity of the lien in the absence of notice of it is questioned by the plaintiff corporation, but in this proceeding there would seem no basis for such questioning by the corporation itself or its incorporators as against the debenture holders, because all of them have actual notice of the lien, and the record now discloses no others interested in and opposing the lien provisions.

No doubt there was a secondary intention in the minds of the incorporators to permit the prospective holder or holders of these certificates to have some contingent equitable interest in the corporate assets; but it was their primary intention at the time of the creation and issuance of these certificates, that they should not be stock.

It was to the interest of the corporation, as interpreted by the management of it, to issue these de-

benture certificates, because in doing so the taxpayer corporation was obtaining some valuable voting stocks in certain brewery corporations, and was also obtaining a certain limited sum of money,—limited in the sense of being not so great as the par value of the brewery stock received in payment for the issuance of the debenture certificates.

The corporation very likely held out to the prospective certificate holder as much inducement as was available; and I dare say that one of the talking points was the contingent interest which the certificate holder was to have in the assets of the corporation in case of a dissolution of the taxpayer corporation or in case of the calling in and [13] maturing of the debenture certificates before normal redemption.

Now, then, respecting the actual intention of the corporation and its management after the certificates were issued, it appears when the corporation desired to obtain loans from the bank that it did then intend, and I believe the evidence establishes that it then did actually intend, that these certificates should be regarded as shares of equitable stock interest in the company, and apparently the president of the corporation when seeking the loan from the bank entertained no doubt at all in his mind that the certificates had that effect.

On the other hand, it just as clearly appears that, when the corporation went to compute and pay its income taxes, it on that occasion just as clearly intended that the nature of these certificates should

be indebtedness, and not stock of any nature, and claimed as a deduction from gross income the interest paid on such debenture certificates as interest paid on corporate debts.

So we have a situation that, when the corporation wanted to borrow money from the bank, it intended that the certificates of debenture should be regarded as stock; but when the corporation was paying its income tax, it then intended that such debentures should be regarded as debts. It seems reasonable to conclude from the evidence that the corporation's financial interest was the factor determining whether the corporation would regard the debentures as corporate stock or corporate debt. The corporation obtained a financial benefit through the bank loans by regarding and representing the debentures as stock instead of debt, because [14] the bank would not have made the loans if the debentures had been regarded as debt (Tr. 38). Obviously it was to the corporation's financial interest when making its income tax returns to reduce the amount of its tax by claiming as a deduction from gross income the interest it had paid on the debentures, and that could be done only by asserting (and the corporation did so assert) that the debentures were corporate debts instead of stock.

And so the intention of the taxpayer when borrowing money that the debentures should be regarded as corporate stock offsets the taxpayer's intention when computing and paying income tax that the debentures be regarded as corporate debt. Such

conflicting intention nullifies any aid that the Court, when construing these debentures, might get from the corporation's attitude respecting the nature of the debenture certificates, and, in the absence of other convincing evidence of the intention of either the corporation or the certificate holders, the Court is left to determine the nature of the debentures and the intention of the issuer and holders thereof from the writing itself.

As has already been indicated, the writing itself primarily and essentially is the statement of a debt, because it contains an acknowledgment of a certain present amount of indebtedness with an absolute promise to pay that amount (with interest payable out of net earnings and certain other ascertainable contingent benefits) at a definite time in the future, with provision for accelerating maturity, all obligations being secured by lien on all of the corporation's property, notwithstanding participating dividend and asset distribution features. Plaintiff taxpayer has failed to [15] establish that the debentures are corporate capital stock investments at the risk of the business of the corporation.

Considering what has been said and all the evidence in this case, the Court finds, concludes and decides that plaintiff taxpayer is a personal holding corporation with less than five stockholders and without right to recover back the tax it has previously paid and herein seeks to recover, and that the plaintiff's action should be dismissed.

Do you wish the matter continued to a definite

time to settle the findings, conclusions and judgment, or do you wish——

Mr. Jones: (Interposing) I would rather if your Honor would leave it open. We will get to it as soon as possible. There are some matters that I would want to prepare findings on. I will expect to ask your Honor to make a specific finding under the evidence of intent at the time of the incorporation. Your Honor didn't mention it.

The Court: Well, at that time I think the intention of the corporation was that these should be certificates of indebtedness, rather than certificates of shareholder's interest.

Mr. Jones: Your Honor has in mind the positive testimony of Mr. Chadwick and Mr. Sick on that point?

The Court: I just feel that—that is my construction of the whole thing. I feel that the written instrument has to govern that intention. They had a secondary intent, Mr. Jones; I believe that they had a secondary intent to let the certificate holder in some respects share in the corporation's asset distribution if there ever came one, or if there ever came an accelerated maturing of the indebtedness. But [16] I do not think the incorporators actually intended, as distinguished from the written expression of such intent, a primary intent other than what the written statement expressed.

Mr. Jones: I mention this because, while the thing is fresh in your mind, it might be well to express this point. Does your Honor have in mind

that Mr. Sick was acting, at the time of the incorporation, not only for the new corporation, Washmont, but also for Associated, and that the testimony showed that Mr. Kerr, one of the directors of Associated, and Mr. Bronson as its attorney, were parties to this understanding? There was no testimony about Mr. Bronson particularly, but there was that Mr. Sick, as representative of Associated, and Mr. Kerr, as director of Associated, were advised and approved of the set-up as being a set-up of a stock-owning interest by Associated or an investment interest by Associated?

The Court: One reason for my feeling that way about it, Mr. Jones, is that there isn't any question about the outstanding ability of legal counsel connected with the set-up of this corporation, and they and their clients knew the difference between a debt and stock, and they expressed what they then and there primarily intended to express, in my opinion, with this secondary subordinate intention that I have discussed.

Mr. Jones: I just thought it was fair to raise these matters now while it is fresh in mind, and we will raise them by proposed findings.

The Court: The corporations were represented by outstandingly able lawyers, who undoubtedly appreciated and advised their clients of the full situation here presented in [17] these issues.

JOHN C. BOWEN

U. S. District Judge

[Endorsed]: Filed Jan. 19, 1942. [18]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause having come on regularly for trial before the undersigned Judge of the above-entitled Court on the 28th day of October, 1941, the plaintiff having appeared and having been represented by Jones & Bronson, and the defendant having appeared and having been represented by J. Charles Dennis, United States Attorney for the Western District of Washington, Harry Sager, Assistant United States Attorney for said district, and Thomas R. Winter, Special Attorney, Bureau of Internal Revenue, his attorneys; and witnesses having been sworn and having testified on behalf of plaintiff and defendant, and exhibits having been introduced in evidence and at the close of the trial, the cause having been taken under advisement and for the submission of briefs, and such briefs having been submitted, and after supplemental proof on January 15, 1942, and oral argument the Court, on January 19, 1942, having filed its memorandum decision herein, and the Court being fully advised, now makes the following:

FINDINGS OF FACT

I.

That the defendant herein, prior to the 8th day of July, 1940, was and at all times material to this action has been, the Acting Collector of Internal

Revenue [19] for the Collection District of Washington, having his office and residing at the City of Tacoma within the jurisdiction of this court; that the acts done by the defendant as herein alleged were done by him in his representative capacity and under and pursuant to the directions of the Commissioner of Internal Revenue of the United States.

II.

That the plaintiff is and at all times herein mentioned was a corporation organized and existing under the laws of the State of Washington and having its principal place of business at the City of Seattle, King County therein, and making its returns under the Federal income and excess-profits acts to the Collector of Internal Revenue at Tacoma, Washington; that plaintiff has at all times borne true faith and allegiance to the government of the United States and has not in any way aided, abetted or given encouragement or comfort to any person, persons or government in rebellion against the United States, nor has it aided, abetted or given encouragement to any sovereign or government which has been or is at war with the United States.

III.

That pursuant to the requirements of the Federal income and excess-profits tax laws (now Internal Revenue Code) then in force and effect, the plaintiff duly filed its income tax returns with the de-

fendant for the taxable years 1937 and 1938 as an ordinary corporation, and within due time paid to the defendant all tax liability arising thereunder.

IV.

That thereafter the Commissioner of Internal Revenue caused an audit to be made of said returns as a result of which he held and determined that during each of said years the plaintiff constituted a personal holding company and was [20] subject to tax as such under and pursuant to provisions of Section 351 of the Revenue Act of 1936, as amended by the Revenue Act of 1937 and Section 401 of the Revenue Act of 1938, the provisions of which acts, with reference to the matter here in controversy, are substantially identical. The Commissioner of Internal Revenue further held that the plaintiff was required to file and was delinquent by reason of not filing a return as a personal holding company on Form 1120-H for each of said years. Thereupon and by reason of such holding and determination the Commissioner of Internal Revenue held that this plaintiff was subject to assessment for and he did thereupon determine and assess a deficiency in income taxes under the personal holding company sections of the applicable revenue acts in the sum of $2,759.71, together with a penalty for failure to file a personal holding company return of $685.55, making a total of $3,445.26 for the year 1937 and of $2,097.16, together with a penalty for failure to file a personal holding company return of $582.88, making a total of $2,680.04 for the year 1938.

V.

That thereafter and pursuant to such determination of the Commissioner of Internal Revenue and on or about July 8, 1940, the plaintiff paid to the defendant, as Acting Collector of Internal Revenue for the Collection District of Tacoma, the sum of $6,815.32, being the amount of said deficiencies and interest thereon as above set forth, together with interest applicable to the deficiency for 1937 amounting to $478.56 and for the year 1938 amounting to $211.46.

That thereafter and on or about July 19, 1940, plaintiff [21] filed with the defendant, as Acting Collector of Internal Revenue for the Collection District of Tacoma, claims for refund of said payment of deficiencies and interest amounting to the said sum of $6,815.32.

VI.

That thereafter under date of December 13, 1940, the Commissioner of Internal Revenue notified the plaintiff in writing of the rejection of said claims in their entirety except there has been refunded to the plaintiff the sum of $121.34 determined as an overpayment of interest on the assessments above mentioned and which is properly to be credited in reduction thereof.

VII.

That the Associated Breweries of Canada, Ltd., was a corporation organized under the laws of the

Dominion of Canada and at no time during 1937 and 1938 was fifty percentum or more in value of its outstanding stock held directly or indirectly by or for five or less individual stockholders.

VIII.

That, as more fully appears from the Court's memorandum decision filed January 19, 1942, hereby made part hereof, plaintiff's incorporators at the time of the issuance of the debenture certificates intended them to represent indebtedness of the plaintiff and not legal stockholder interest in plaintiff; that by the written terms of the certificates themselves, they created and were intended to create an indebtedness against the plaintiff corporation rather than a stockholder's interest therein, which fact is in the certificates manifested by an acknowledgment of the corporation's indebtedness for, and by an absolute promise to pay, the face value of the certificate (with interest and participating benefits to be conditionally paid) and by a provision [22] giving the certificate holder a lien on all of the plaintiff corporation's property, present and future, to secure the payment of its obligations under the certificates.

IX.

The income realized by the plaintiff which was not a regular dealer in stocks and securities during the taxable years 1937 and 1938 was derived from royalties, dividends, interest and/or gains from the sale of stock or securities and during the last half

of each of those taxable years more than fifty percentum in value of its outstanding stock was owned directly or indirectly by not more than five individuals.

From the above and foregoing Findings of Fact, the Court deduces the following:

CONCLUSIONS OF LAW

I.

That the income, realized by the plaintiff corporation for the taxable years 1937 and 1938, meets the requirements of Section 351 of the Revenue Act of 1936 as amended by the Revenue Act of 1937 and Section 402 of the Revenue Act of 1938 and during the last half of said years, more than fifty percentum in value of its outstanding stock was owned directly or indirectly by not more than five individuals, and the plaintiff was a personal holding company for the years 1937 and 1938 within the meaning of said statutes.

II.

That the taxes, penalties and interest assessed and collected were in all respects legal and in strict accordance with the law.

III.

That plaintiff's alleged cause of action should be [23] dismissed with prejudice and with costs to the defendant.

Done in Open Court This 4th Day of March, 1942.

JOHN C. BOWEN

United States District Judge

Presented by:

THOS. R. WINTER
Special Attorney, Bureau of Internal Revenue.

[Endorsed]: Filed Mar. 4, 1942. [24]

United States District Court
Western District of Washington
Southern Division

No. 216—Tacoma

WASHMONT CORPORATION, a corporation,
Plaintiff,

v.

THOR W. HENRICKSEN, individually and as Acting Collector of Internal Revenue for the Western District of Washington, Southern Division,
Defendant.

JUDGMENT

This cause having come on regularly for trial before the undersigned Judge of the above-entitled Court on the 28th day of October, 1941, the plaintiff having appeared and having been represented by Jones & Bronson, and the defendant having appeared and having been represented by J. Charles Dennis, United States Attorney for the Western District of Washington, Harry Sager, Assistant

United States Attorney for said district, and Thomas R. Winter, Special Attorney, Bureau of Internal Revenue, his attorneys; and witnesses having been sworn and having testified on behalf of plaintiff and defendant, and exhibits having been introduced in evidence and at the close of the trial, the cause having been taken under advisement and for the submission of briefs and such briefs having been submitted, and after supplemental proof on January 15, 1942, and oral argument, the Court, on January 19, 1942, having filed its memorandum decision herein, and the Court having heretofore made and entered its Findings of Fact and Conclusions of Law, and being fully advised in the premises,

It Is Hereby Ordered, Adjudged and Decreed that the above-entitled action be, and the same is hereby dismissed [25] with prejudice and with costs to the defendant to be taxed by the Clerk.

Done in open court this 4th day of March, 1942.

JOHN C. BOWEN

United States District Judge

Presented by:

THOMAS R. WINTER.

[Endorsed]: Filed Mar. 4, 1942. [26]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Washmont Corporation, plaintiff above named, hereby appeals to the

Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on March 4, 1942.

Signed: JONES & BRONSON
H. B. JONES
Attorneys for Plaintiff
Address: 610 Colman Building
Seattle, Washington

Copy delivered to U. S. Attorney, Tacoma, and copy mailed to Thos. R. Winter, Seattle, May 26, 1942.

E. REDMAYNE,
Dep. Clerk

[Endorsed]: Filed May 25, 1942. [27]

[Title of District Court and Cause.]

APPELLANT'S STATEMENT OF POINTS ON APPEAL

Washmont Corporation, plaintiff above named, having taken an appeal from the judgment herein, hereby states the points on which it intends to rely on the appeal, as follows:

I.

During the years 1937 and 1938, Washmont Corporation was not a personal holding company within the provisions of Section 351 of the Revenue Act of 1936 as amended by the Revenue Act of 1937 and Section 402 of the Revenue Act of 1938, as deter-

mined by the Commissioner, for the reason that its outstanding issue of $625,000.00 par value securities, denominated "Participating Dividend Debentures", was not, and was not intended to be, a debt, but was, and was intended to be in fact and in law a proprietary interest in said corporation, representing capital at risk in the business, and that therefore fifty per cent (50%) or more of the outstanding stock of said Washmont Corporation was not owned directly or indirectly by not more than five (5) individuals at any time during the last half of said years.

II.

In the creation of Washmont Corporation and the issuance of said debentures, and at all times thereafter, it was the intent and purpose of Washmont Corporation and of Associated Breweries of [28] Canada, Ltd., to which said debentures were issued, and by which they were held, that the said debentures should not constitute a debt of Washmont Corporation, but should represent a proprietary interest constituting capital at risk in the business of Washmont Corporation.

III.

That said debentures constituted an outstanding stock interest of Washmont Corporation during said years, and should be considered as stock in determining the status of Washmont Corporation as a personal holding company during said years.

IV.

In determining the purpose and intent of Washmont Corporation in issuing said debentures and of Associated Breweries of Canada Ltd., in receiving them, and the character of such securities with reference to the personal holding company status of Washmont Corporation, the Court should have considered and received in evidence the offer made by the plaintiff establishing that in April 1940, immediately after the Commissioner of Internal Revenue determined that Washmont Corporation was a personal holding company during 1937 and 1938 by reason of said debentures being outstanding, the said Washmont Corporation issued and exchanged for said debentures and Associated Breweries of Canada Ltd., holders of said debentures, accepted in exchange therefor a like amount of par value preferred stock.

(Signed) H. B. JONES

Attorneys for Appellant

Copy received this 5th day of Aug., 1942.

THOMAS R. WINTER

[Endorsed]: Filed Aug. 11, 1942. [29]

[Title of District Court and Cause.]

APPELLANT'S STATEMENT OF EVIDENCE

The above entitled action came on regularly for hearing October 28, 1941 before Honorable John C.

Bowen, sitting without a jury, in the above entitled court at Tacoma, Washington.

Plaintiff appeared by its attorneys H. B. Jones and R. B. Hooper of Jones and Bronson of Seattle, Washington; and Defendant by his attorneys J. Charles Dennis, United States District Attorney, Harry Sager, Assistant United States District Attorney, and Thomas R. Winter, Special Attorney, Bureau of Internal Revenue, all of Seattle, Washington.

The opening statements of Counsel having been made, there was offered by the plaintiff and received in evidence as plaintiff's Exhibit 1, the statutory 90 day assessment letter addressed by the Commissioner of Internal Revenue to the plaintiff dated June 28, 1940 relating to deficiency for the calendar year 1937 setting forth a deficiency and penalty as alleged in Paragraph IV of plaintiff's complaint, based upon the determination that plaintiff was a personal holding company and had failed to file a return as such for each of said years.

ALBERT BRYGGER

was thereupon called on behalf of the plaintiff herein, and having been first duly sworn, testified as follows: [30]

I am a resident of Seattle, and am, and was in 1937, president of the People's National Bank of Washington, I know Mr. Emil G. Sick and the Washmont Corporation; the Bank handled their

(Testimony of Albert Brygger.)

banking business and has done so since 1937. In October, 1937, at the request of Mr. Sick, a loan was made to the Washmont Corporation; on October 7th, Mr. Sick and I had a telephone conversation concerning his desire to borrow $22,000.00 on behalf of the Washmont Corporation. I asked Mr. Sick about the Washmont Corporation; he said that it had no debts, that it had a capital of $25,000.00 and that the company had issued participating dividend debentures in the amount of $625,000.00 which were owned by the Associated Breweries. After his assertion that they were considered as capital, I made him the loan of $22,000.00. I knew that I was talking to Mr. Sick over the telephone at that time; I have talked to him so much that I couldn't fail to recognize his voice.

I kept a memorandum of this conversation, and the representations made to me. It was prepared two or three hours after the conversation and its purpose was to create a record in the credit files of the bank so that other officers might know about the transaction. In our particular Bank it is customary for each man to make a report of this kind with respect to customers interviewed each day. This record was made in accordance with that practice.

In the consideration of this loan by the bank's executive committee, the representation was made that the entire amount of the debentures were capital and not debt. If we had considered them a debt, we of course would never have made the loan, because the debt would have been too large.

(Testimony of Albert Brygger.)

Other loans were made with Mr. Sick after this one over a period from 1937, to January 4th, 1940. During the course of these transactions I had further conversations with Mr. Sick *con-* [31] concerning the character of the debentures, to the effect that they were capital of the company.

These transactions ran over a period from 1937 to January 4, 1940, and the dates and amounts were as follows:

October 7, 1937	$22,000
December 22, 1938	10,000
June 2, 1938	25,000
June 20, 1938	40,000
August 24, 1938	35,000
November 12, 1938	4,000
May 29, 1939	5,000
January 4, 1940	12,500

I have a memorandum of a conversation with respect to each of these loans. They kept the record in the credit files prepared within two or three hours after each conversation. Each man in our bank writes down the name of the customer he interviews, and at the end of the day dictates for the credit file the circumstances of the conversation with the customer, and whether or not he granted or declined the loan. I have with me the various memoranda prepared in this way with respect to loans to Washmont Corporation which were put in the credit files of the bank and kept there ever since.

(The memoranda so produced was identified as plaintiff's Exhibit 2 and offered in evidence

(Testimony of Albert Brygger.)

by the plaintiff, to which an objection was made and sustained.)

The pertinent portions of said Exhibit 2 for identification are as follows:

"WASHMONT CORPORATION"

"October 7, 1937—

"The Washmont Corporation has total assets of $667,000 with no liabilities other than capital, and is a holding company for brewery stock with ownership in the Sick family. Their statement shows participating debentures of $625,000. These debentures are owned by the Sicks and considered by them to be capital.

"June 2, 1938—

"Obtained a new statement which shows investments [32] in the following companies:

Stocks of U.S. companies aggregating $626,-693.10, Total assets $657,097.00, and their only debt is a $4000 mortgage payable; $5226 reserve for taxes; they have participating debentures outstanding of $625,000, and capital and surplus of $22,800."

Cross-Examination

I understood that Washmont Corporation was a holding company of brewery stocks. Mr. Sick told me that there were participating dividend debentures of that company issued and outstanding in October, 1937. I did not know at that time that Mr. Sick had also transferred to Washmont Corporation 1000 shares of stock of the Seattle Brewing and

(Testimony of Albert Brygger.)
Malting Company. I understood that Associated Breweries Ltd., were the stockholders of the Washmont Company by virtue of the debenture certificates. This was what Mr. Sick told me. The loan was made to the Washmont Corporation on the basis of what he told me, and on the basis of his credit and that of Washmont Corporation. He did not personally endorse any of the obligations.

On October 7, 1937, I understood that Mr. Sick and the Associated Breweries were the stockholders of the Washmont Corporation. At that time there were outstanding in participating dividend debentures $625,000 and the total assets at that time were about $667,000. We contemplated loaning him $22,000; we would require more than double this amount in security in marketable stocks and bonds, and if there had been a debt of $625,000 against them no loan would have been made. Mr. Sick said that there were no liabilities and I took his word for it, which is standard banking practice with some people.

STEPHEN F. CHADWICK

was thereupon called on behalf of the plaintiff herein, and having been first duly sworn, testified as follows:

I am an attorney and have practiced in the City of Seattle [33] since 1915. I was the attorney who set up the Washmont incorporation; was one of the

(Testimony of Stephen F. Chadwick.)
incorporators, and have been a trustee and director in the corporation since its organization.

I was requested by Mr. Sick to organize the Washmont Corporation. My conversations prior to its organization were with Mr. Sick and Mr. R. H. B. Ker, of Victoria, B. C., who is one of the men principally interested in, and a director of the Associated Breweries Ltd., of Canada; Mr. Robert Bronson, at that time, was retained as counsel for the Associated Breweries in the State of Washington and, in the preliminaries of setting up the corporation, I talked with and submitted the articles and plans for the corporation to him before it was finally set up.

Mr. Sick was president of the Associated Breweries and also president of Seattle Brewing and Malting Company. Mr. Ker was a director and, I believe, vice president.

The issuance of the debentures was in our minds at the time the articles of incorporation were prepared and the steps had been fully discussed between all of us. The occasion for the formation of the corporation was that the Associated Breweries Ltd., of Canada, was a Canadian Corporation. It was considered desirable to bring the voting control of that stock into the State of Washington and lodge it with a citizen of that state, and Mr. Sick came into that position. A corporation was set up with the intent and endeavor on my part to create a situation where the Associated would share on an equality and parity with such investment as Mr.

(Testimony of Stephen F. Chadwick.)
Sick might wish to make in the Washmont Corporation. In April 1937, when the Corporation was being set up, there was a discussion among Mr. Sick and Mr. Ker and myself relative to the position that the debentures would occupy with reference to the claims of general creditors of the company. The stocks were to be brought down and these participating dividend debentures were to be [34] issued. We agreed upon three per cent as a figure which the corporation would be sure to be able to pay as a dividend in any one year; accordingly, we set up a provision that if it were earned, three per cent would be paid on the participating dividend debentures. Then, after three per cent was paid on the stock of the corporation, the participating dividend debentures would share equally in all earnings of the corporation which might be available for declaration of dividends. There was specific discussion as to the relation of the debentures to the claims of general creditors and it was agreed that the interests of Associated and Mr. Sick would be equally at hazard with reference to such claims.

I drew the debentures, and in so doing it was my intention to create a stock interest in the company to the extent of a right to participate in the earnings or to be impressed with the liabilities of the company, though not strictly a stock in the sense of represented stock on file with the Secretary of State.

The witness was then asked what change was made in the corporate structure of Washmont Corporation, after the question was raised by the gov-

(Testimony of Stephen F. Chadwick.)

ernment as to whether the debentures were a debt or a stock interest, and what was the occasion for such change, to which objection was made and sustained. Thereupon Counsel for plaintiff made the following offer of proof:

"Mr. Jones: I offer to prove at this time, then, by this witness (I think I should make an offer of proof for the record) that upon the issue being raised by the Revenue Agent's office that he would interpret this to be an evidence of debt rather than a stockholding interest, that the witness, acting for the Washmont Corporation and with the consent of the Associated, forthwith took steps to cause the debentures to be surrendered and replaced by issuing what was denominated "preferred stock" and that was the sole reason for taking [35] that step and no other.

"Mr. Winter: We object on the ground it is not relevant to the issues in this case as to what was done later, isn't here involved. The question is whether or not the so-called debentures, were, in effect, evidence of indebtedness or whether the stockholders had showed stock ownership in the corporation.

"The Court: The objection is sustained on the time element, particularly."

Cross-Examination

The articles of incorporation and by-laws of Washmont Corporation were offered and received in evidence as plaintiff's Exhibit 3 and so far as material are as follows:

(Testimony of Stephen F. Chadwick.)

"ARTICLES OF INCORPORATION

ARTICLE IV.

"The purposes and objects for which this corporation is formed are as follows:

"1. To subscribe for, purchase or otherwise acquire, to sell, exchange, pledge or otherwise dispose of, for its own account and/or the account of others, of shares of stock, debentures, bonds or other securities issued by any individual, corporation, association or partnership or issued by an*d* public authority, whether governmental, foreign, domestic, municipal, local or otherwise.

"2. To purchase, acquire, sell, exchange, hypothecate, pledge, mortgage or otherwise deal in, and to dispose of, all choses in action, real, personal or mixed property of every kind and character and wheresoever situate and to borrow money upon its own account and for the account of others and to lend money upon the security of all manner of ch*a*ses in action, securities of every kind and character and property, real, personal or mixed.

"3. To invest the funds or the credit of the corporation in, or to advance or lend money upon the credit of any individual, corporation, association or partnership or upon the security of real or personal property or choses in action or securities of whatever kind and nature.

"4. To aid in any manner any corporation

(Testimony of Stephen F. Chadwick.)

or association, the bonds, securities or other evidence of indebtedness of which or the shares of stock in which are held by or for this corporation or in which or in the welfare of which this corporation shall have any interest, and to do any acts or things designed to protest, preserve, improve or enhance the value of any such bonds or securities or evidences of indebtedness or such shares of stock [36] or other properties of this corporation.

"5. To borrow or raise money for any of the purposes of the corporation, to issue bonds, debentures, notes or other obligations of any nature or in any manner for moneys so borrowed, and to secure the payment thereof and the interest thereon by mortgages upon or pledge or conveyance or assignment of the whole or any part of the earnings or property of the corporation, real, personal or mixed, including contract rights, whether at the time owned or thereafter to be acquired, and to sell and pledge such bonds, debentures or other obligations of the corporation for its corporate purposes.

"6. To guarantee the payment of dividends upon any shares of the capital stock of or the performance of any contract by any other corporation or association in which this corporation has an interest and to endorse for or otherwise guarantee the payment of the principal and interest or either of any bonds, debentures, notes, securities or other evidences of indebted-

ness created or issued by any other such corporation or association.

"7. To acquire the good will, rights and property and to underwrite the whole or any part of the assets of any person, firm, association or corporation and to pay for the same with stock of this corporation or upon such terms, whether for cash or credit as may be agreed upon; to hold or in any manner dispose of the whole or any part of the property so purchased; to conduct in any lawful manner the whole or any part of the business so acquired and to exercise all the powers necessary or convenient in or about the conduct and management of such business.

"8. To do, either as principal, agent, factor, contractor, or otherwise, and either alone or in connection with one or more firms, individuals, or other corporations, anything and everything necessary, suitable, convenient or proper for the accomplishment of any of the purposes or the attainment of any one or more of the objects herein enumerated, or incidental to the powers herein specified, or which shall at any time appear conducive to, or expedient for, the accomplishment of any of the purposes, or for the attainment of any of the objects hereinbefore enum*b*erated, if not inconsistent with the laws of the state of Washington.

(Testimony of Stephen F. Chadwick.)

"ARTICLE V.

"The total authorized capital stock of this corporation shall be fifty thousand (50,000) shares, having a par value of One ($1) Dollar each and being all of one class and with the same rights, voting powers, privileges and restrictions.

"ARTICLE VI.

"The amount of paid-in capital with which the corporation will begin business shall be the sum of Twenty-five Thousand ($25,000) Dollars. [37]

"ARTICLE VII.

"The first board of directors who shall manage the concerns of this corporation and their postoffice addresses and terms of office are as follows:

EMIL G. SICK
814 Second Avenue
Seattle, Washington 6 months

S. F. CHADWICK
656 Central Building

O. H. MILLS
656 Central Building
Seattle, Washington 6 months

"BY-LAWS"

"ARTICLE V.

"Certificates of Stock

(Testimony of Stephen F. Chadwick.)

> "Certificates of stock shall be separately numbered and shall be entered in the books of the corporation as they are issued. They shall exhibit the holders' names and the number of shares, and shall be signed by the president or a vice-president and the secretary and/or assistant secretary.
>
> "ARTICLE VII.
>
> "Trustees' and Stockholders' Meetings
>
> "At all meetings of the stockholders, each stockholder shall be entitled to one vote for each share of stock held by him.
>
> "ARTICLE VIII.
>
> "AMENDMENTS.
>
> "These by-laws may be altered or amended by vote of a majority in amount of all of the stockholders at any annual meeting or at any special meeting of the stockholders called for that purpose."

The minutes of the first meeting of the board of Trustees of Washmont Corporation held April 31, 1937, at which the by-laws of the company were adopted, were submitted in evidence and showed the following proceedings:

"Mr. Sick suggested that in satisfaction of his subscription to the 24,800 shares of the capital stock of the corporation and in satisfaction of the subscriptions of S. F. Chadwick and O. H. Mills,

(Testimony of Stephen F. Chadwick.)

each for 100 shares, he proposed to transfer to the corporation 1000 shares of the capital stock of Seattle Brewing & Malting Company. The trustees having considered said proposal and [38] being of the opinion that said shares of stock were reasonably worth the sum of $25,000, said sum being the aggregate of the subscriptions mentioned, the following resolution was duly and unanimously passed:

> 'Resolved that this corporation, in satisfaction of the subscriptions heretofore made by Emil G. Sick, S. F. Chadwick and O. H. Mills, aggregating a subscription to 25,000 shares of $1 par value each of the capital stock of this corporation, accept the offer of Emil G. Sick to transfer 1000 shares of the capital stock of Seattle Brewing & Malting Company to this corporation, and that such transfer be and the same is hereby accepted, and that the said stock be issued as fully paid and the said subscription to capital stock satisfied.'

"The president stated to the meeting that the opportunity might be available to the company to acquire substantial blocks of stock in four operating breweries in the states of Washington and Montana; that as this opportunity might be presented to him while visiting in Calgary, Alberta, he invited the consideration of the board of the authorization of the issuance of participating dividend debentures to the amount of $625,000, in denominations one of $500,000 and five of $25,000, to be used for the purpose of acquiring such stocks at their current, fair

(Testimony of Stephen F. Chadwick.)

market value, aggregating $595,245 and the further acquiring of $29,755 in cash.

"Mr. Chadwick then submitted to the meeting a form of participating dividend debenture which he had prepared, which was given careful consideration by the board and a copy of which is hereto attached and by reference made a part of the minutes of this meeting, and upon motion duly made and seconded, the following resolution was unanimously passed:

> 'Resolved that the president of this corporation be and he hereby is authorized to negotiate for the purchase of capital stock of Seattle Brewing & Malting Company to the extent of 12,500 shares at the fair value of $24.50 per share; 740 shares of Missoula Brewing Company at the fair value of $188 per share; 54,460 shares of Great Falls Breweries, Inc., at the fair value of $1.25 per share; and 409 shares of Goetz Breweries, Inc., at the fair value of $200 per share; and for cash in the sum of $29,755; and if said stocks and cash be found available, to deliver in payment therefor the participating dividend debentures of this company in the [39] aggregate total amount of $625,000, in denominations of one for $500,000, and five for $25,000, and in form of the sample debenture, copy of which is attached to and made a part of the minutes of this meeting, the said debentures, if such sale be consummated by said date, to be dated April 30, 1937.'

(Testimony of Stephen F. Chadwick.)

"Mr. Chadwick reported that he had communicated with the Director of the Department of Licenses of Washington with reference to whether or not any permit might be required from that Department in connection with the issuance of the company's debentures in the contemplated transaction covered by the foregoing resolution and advised that he was in receipt of a letter from the Director of the Department of Licenses of Washington stating that as there was no public offering, it would not be necessary to take the matter up with his office. The letter received by Mr. Chadwick was then filed with the Secretary to be attached to the minutes of this meeting."

Cross-Examination of
Stephen F. Chadwick (Continued)

It was intended that the hazard as to the investment of Associated Breweries and Mr. Sick should be on an equal basis. Except for Mr. Sick's substantial interests in both Associated and Washmont, Associated was to have no voice or vote in the corporate affairs of Washmont by reason of its ownership of debentures. In consideration of the issuance of these debentures, Associated Breweries put up stock and cash of $625,000.00. It was provided that the debentures were a lien upon the property of Washmong Corporation, but the term meant only that the debentures were a lien upon themselves.

I understood that what was denominated "inter-

(Testimony of Stephen F. Chadwick.)

est'', was only payable out of net profits if earned and that this was true also of the dividends. The tax return shows that both dividends and interest were paid upon the debentures. 3% of the face value of the debentures was denominated "interest'', and dividends were to be paid out of whatever was left available from net earnings, [40] to the end that all net earnings should be distributed.

The debentures recited that they were payable in twenty years, but there was nothing out of which they could be paid except by retiring the capital of the corporation. There was no way to accumulate any surplus off the stock because whatever was earned every year was declared and paid out. It was not the same situation as the payment of a mortgage. The securities held had a readily realizable market value and were dealt in on the market.

Redirect Examination

Referring to the provision that the debentures should be a lien upon net earnings of the company, no mortgage of any kind was ever given to support the debentures, and no steps taken to fix a lien, beyond the reference in the debenture itself.

EMIL G. SICK

was thereupon called on behalf of the plaintiff herein, and having been first duly sworn, testified as follows:

(Testimony of Emil G. Sick.)

I am the president of Washmont Corporation and am also president and a stockholder of Associated Breweries, Ltd., of Canada. There are about 600 stockholders in Associated Breweries, and the same number existed in 1937 and 1938. There was an original preferred issue of Associated Breweries stock in the amount of $1,500,000.00 now reduced to about $750,000.00, and in addition $240,-000.00 in no par common stock. At no time during 1937 was 50% or more of the stock concentrated in the hands of five or less persons.

Associated Breweries owned outright the entire stock in five operating Breweries in Western Canada and had brewery investments in the form of stocks in the United States. .It had been engaged in business thirteen years during which I have been connected with it, as well as members of my family. My father was the original president, I was the original manager and director. [41]

After the repeal of prohibition I came down here and established breweries in Great Falls, Missoula, Spokane and Seattle and invested in the Olympia Brewing Company and Seattle Brewing and Malting Company was formed in the summer of 1933.

I supervised the initiation of all these United States enterprises, and in that connection came to Seattle to live. In promoting these enterprises, I desired to have them controlled and owned locally. In 1937 Associated owned stocks in these companies totaling about a million dollars.

(Testimony of Emil G. Sick.)

The whole intended purpose of forming Washmont Corporation was to provide local control. It was arranged that Associated was to get the same comparative value for the shares which it turned over to Washmont Corporation, in these United States brewing companies, without any vote, so that control would be local. Associated turned in to Washmont Corporation enough shares of each of the companies concerned to make local control. In return for the shares which Associated turned in, it received back the so-called participating dividend debentures. It was my intention that the participating dividend debentures should stand behind the creditors of Washmont; that the debentures were stock at the risk of the business. I reported to the directors of Associated, that their investment was substantially the same in form as it had been, except that they had lost their vote. They approved this.

I had occasion to borrow some money from Peoples National Bank on behalf of Washmont in 1937, and communicated with Mr. Brygger by telephone in October of that year. In referring to the debentures on the statement, I told him that the stock was really free and that I could leave any amount with him as security. By that I mean that the whole investment portfolio was free, and that I could hypothecate the stocks and that there was no lien against them. These stocks in the investment portfolio contained the whole [42] value of the company; they were free for me to do with as

(Testimony of Emil G. Sick.)

management dictated. The debentures had no lien upon them actually except to share the same as my common stock, as was definitely agreed upon. My common stock and the debentures were exactly on the same basis per dollar, except that they didn't vote and I did. The whole purpose was to make local control. We called them "debentures" because they had no vote.

Cross-Examination

I own less than 10% of the stock of Associated Breweries, and my family controls less than 33%. The purpose in forming Washmont Corporation was to get local control of these United States breweries, particularly Seattle Brewing and Malting. When local control was obtained it was not actually obtained by myself. I retained control of these other breweries, only by adding my Washmont stock to other American shares. A big block of stock in these American companies was owned locally and voting control was provided by adding it to the further block. I do not have control of Seattle Brewing and Malting either through Washmont Corporation or the ownership of other additional stocks. I own about one-third of the stock in Washmont Corporation and Seattle Brewing and Malting Company. I am president of the latter and of the other breweries, and have been the active managing head since the repeal of prohibition. The outstanding stock of Seattle Brewing and Malting is a million and a half shares and there is no other voting stock in that corporation.

(Testimony of Emil G. Sick.)

In determining the value of the stock of Washmont Corporation issued to me, Associated Breweries and I traded in our stock for other securities, at book value, plus 20%. I turned in 1000 of the old shares of capital stock of Seattle Brewing and Malting Company, which were then selling at around $20.00. In return, I took book value plus 20%, or a fifth, in shares of Washmont [43] Corporation, Associated Breweries also took book value plus a fifth. Associated Breweries in all cases turned in enough shares to make local control. The book value of that stock turned in, plus 20%, made $625,000.00.

The common stock and debentures were supposed to be exactly on the same basis, except that the common stock did all the voting. Although it is provided in the debentures that they shall draw interest at 3% before any dividend on the common stock, this results in equality because the rate is made so low that the common stock also draws 3%. Unless earnings were sufficient to pay 3% to both the debenture holders and the stockholders, nobody would get anything. I was very explicit with Mr. Ker on that point in setting the corporation up. The intention was to make the stock and debentures exactly even, and it was provided that interest should first be paid on the debentures, in order to justify giving all the voting power to the common stock. The interest rate was made so low that it was inconceivable to us that the common would not share in it too. It is my view, that reading the

(Testimony of Emil G. Sick.)

terms of the debentures, those debentures could not be paying 3% without the common getting 3%. I don't think the provision provides for priorities for the debentures. It is my conception that the common stock is entitled to dividends at exactly the same rate as the debentures. I got the idea to some extent from the set-up of the Olympia Brewing Company, where the common and preferred share equally, and those shares sell for exactly the same on the market, because it is commonly understood that preferred and common are on the same basis. We wanted to make a distinction in the holding, since we could not make it all common and still let some common stock vote and have some not voting. The intention was that they be exactly on the same basis, except that only one kind of stock would do the voting.

The common stock does not provide for a lien upon the [44] corporation's assets. The provisions of the debentures do provide for a lien. But as a common stock investor, I say that I get the same stakes in the wind-up. It is my understanding that the words "lien" and "debentures" have no effect, in this case.

The whole consideration in the consultation with my attorney in drawing up the debentures, was given to making the common stock and the other stock debentures, even. No consideration was given the matter of security; Associated Breweries was not attempting to convert its shares into a better security. That was not the purpose of the transac-

(Testimony of Emil G. Sick.)

tion. At my insistence, Associated Breweries was merely wanting to lose its voting power, so that we would have local control. There was no idea of giving Associated better security in their investment; that didn't enter into it a bit. The whole idea was to crowd the voting power into a few shares, and without my losing anything on my few shares. Mr. Ker was very insistent on that. There was no intent or purpose to give Associated Breweries greater security. The purpose in including a reference to a lien was merely to make some distinction between the two stocks in words, so as to give one the voting power and not the other. It was a distinction only in words. My idea always was that the debentures were actually, to all purposes, preferred stock, and only preferred stock.

The reason for not making these debentures "preferred stock" was that we were advised that the Washington and Montana state laws prohibited aliens from owning land, so that control of the corporations had to be in the hands of citizens, since Washmont Corporation owned stocks in companies, which in turn owned land. We were advised of the Montana law by the Attorney-General in 1933.

Redirect Examination

At the time of issuance of debentures, the general manager of Associated Breweries said that in compliance with the law [45] something other than preferred stock might be required, and the use of the term "debentures" arose out of a discussion between us all.

EDWARD HOOVER

was thereupon called on behalf of the plaintiff herein, and having been first duly sworn, testified as follows:

I am a public accountant and am the manager of the Seattle branch of Price Waterhouse Inc. I have done business with the Washmont Corporation from its inception up to the present time. Representatives of our firm prepared the tax returns for it for 1937 and 1938.

The income tax return of plaintiff Washmont Corporation for the year 1937 was then received in evidence as plaintiff's Exhibit 4. The pertinent portions of said Exhibit 4 are as follows:

Under Schedule A deductions, Item 20 shows interest payment of $12,698.04.

Under Schedule B, Item 1 shows Total Distribution to stockholders charged to earned surplus during the taxable year—$39,750.00.

Under Schedule M Item 1 shows Cash distribution to stockholders out of earnings or profits of the taxable year of $39,750.00.

The income tax return of plaintiff Washmont Corportion for the year 1938 was then received in evidence as plaintiff's Exhibit 5, and the pertinent parts thereof are as follows:

Under Gross Income, Item 20 shows a deduction for interest paid of $19,165.21.

Schedule A, under the heading "Reconciliation," shows a distribution to shareholders of $13,750.00.

The witness then continued:

(Testimony of Edward Hoover.)

The figure shown on line 20 Exhibit 4 designated "interest" amounting to $12,698.04 represents interest on the so-called [46] debentures to the extent of $12,500.00.

In the same Exhibit under Schedule B Item 1 designated 'total distribution to shareholders during taxable year' is $39,750.00 of which amount $37,500.00 represents payment on the participating dividend debentures.

In Exhibit 5 Item 20 shows the amount of $19,-165.21 as an interest deduction of which amount $18,750.00 represents a distribution on the debentures, being 3% on $625,000.00 for one (1) year.

In the same Exhibit, Item 1 of Schedule A shows a total distribution to stockholders charged to earned surplus during the taxable year of $13,-750.00.

Cross-Examination

The item of $13,750.00 above mentioned shown on Exhibit 5 represents a dividend of $1,250.00, and payment on participating debentures of $12,500.00.

Redirect Examination

A deduction was taken for interest on plaintiff's income tax return of $12,500.00 for 1937, and for 1938, $12,750.00.

The minute book of Washmont Corporation having been identified as plaintiff's Exhibit 3. Counsel for the respective parties thereupon offered certain portions of such record, which so far as pertinent to this appeal and the ruling thereon, are as follows:

There was offered by defendant and admitted, affidavit of S. F. Chadwick and O. H. Mills dated April 21, 1937, certifying that the amount of paid in capital, to-wit $25,000, with which Washmont Corportion is authorized to commence business has been fully paid.

There was offered by defendant and admitted, copy of stock certificate of Washmont Corporation, as follows: [47]

"Incorporated Under The Laws Of
The State of Washington

No................. Shares................

WASHMONT CORPORATION
Capital Stock $50,000.00

This certifies that.. is the owner of......................Shares of the Capital Stock of Washmont Corporation [Corporate Seal, 1937, Washington], transferable only on the books of the Corporation by the holder hereof in person or by Attorney upon surrender of this Certificate properly endorsed.

In witness whereof, the said Corporation has caused this Certificate to be signed by its duly authorized officers and to be sealed with the Seal of the Corporation this....................day of ...., A. D. 19........

Shares $1.00 each."

There were offered by the defendant and ad-

mitted, copies of participating dividend debentures of Washmont Corporation, consisting of Debenture No. 1 for $500,000, and Debentures No. 2 to 6 inclusive for $25,000 each, which are identical except for amounts. Certificate No. 1 bears a cancelled Internal Revenue stamp of $500, and each of the other certificates bears cancelled Internal Revenue stamps of $25. A copy of said Debenture No. 1 is as follows:

"PARTICIPATING DIVIDEND DEBENTURE

$500,000.00 —of— No. 1

WASHMONT CORPORATION

The Washmont Corporation, a Washington corporation, hereinafter called the "Company," which term shall include any successor corporation, for value received, hereby acknowledges itself indebted and promises to pay to the registered owner hereof, on or before twenty years from the date hereof, or on a date to be fixed as hereinafter provided and for the retirement of this debenture, the sum of [48] —Five Hundred Thousand ($500,000.00) Dollars—or such other sum as shall be required for retirement in accordance with the terms hereof; and until the principal moneys and all interest and dividends due hereon shall have been fully paid, if the same be earned, to pay

interest thereon at the rate of three (3%) per-cent per annum by equal semi-annual payments on the first day of May and the first day of November in each year.

"This debenture constitutes a lien upon the property and net earnings of the company and the company hereby charges with the payment of its undertaking herein all of its property whatsoever and wheresoever, both present and future.

"The interest due hereon is only payable out of the net earnings of the company for each fiscal year and shall be paid before any dividend shall be set apart and paid to the holders of common stock of the company for such year. The common stock of the company shall, in any year in which interest as herein provided shall have been paid on all debentures of this issue outstanding, be entitled to receive dividends equal to 3% upon the par value of such common stock, after which all funds constituting available net earnings shall be divided ratably in accordance with the face value of outstanding debentures of this issue and par value of outstanding common stock and such fund shall then be distributed ratably as dividends upon the common stock and as participating dividends to the registered owners of debentures of this issue.

"Both principal and interest and participating dividends upon this debenture are payable

to the registered owne*d* at the office of the company in Seattle, Washington, in lawful money of the United States, such payments being subject to deduction for any Federal income tax or other taxes due thereon because of or by reason of any present or future laws of the United States of America or state of Washington.

"This debenture is one of a series designated as 3% participating dividend debentures of an authorized issue aggregating $625,000 and issued in denominations one of $500,000 and five of $25,000 each.

"The debentures of this issue are payable and subject to redemption at the office of the company in the city of Seattle, Washington, twenty years from date or on any interest payment date, or dates, after the company shall have given one month's notice of the intention to pay and redeem the same, by mailing such notice to the record address of the registered holders thereof, by payment of the principal amount thereof, interest, if earned and unpaid, and all unpaid accrued and declared participating dividends due thereon, plus a premium equal to the excess of book value of the then assets of the corporation over the par value of its outstanding common stock and face value of debentures of this issue then outstanding, ratably apportioned to such common stock and to such debentures.

"Upon liquidation of the company prior to payment of the debentures of this issue, the holders thereof shall be entitled to participate in surplus of assets in the same ratable proportion as is provided for their participation in the event of call and redemption. [49]

"This debenture is registered as to principal and interest and participating dividends by registration on the books of the company kept for that purpose in the city of Seattle, Washington, which fact of registration is noted hereon. No transfer shall be valid unless made on said books by the registered owner in person or by duly authorized attorney of such owner and formally noted on the debenture.

"In witness whereof, Washmont Corporation has caused this debenture to be signed in its name by its president or its vice-president and its corporate seal to be hereunto affixed and to be attested by its secretary or assistant secretary, this 30th day of April, 1937.

WASHMONT CORPORATION

By

President"

"Attest:

Secretary"

"REGISTRATION

Notice to the holder: Do not write on this space. This debenture must be registered and

the registration noted hereon by the Secretary or Assistant Secretary of the corporation.

Date of Registry ....

In Whose Name Registered..

Signature of Registering Officer..............................

$500 Documenary Stamp D 44211 D.

Checked 5-17-37.

CLARENCE S. HAGGEN,

Dep. Coll. of Internal Revenue."

There was offered by the plaintiff and admitted in evidence [50] copy of Record of Registration of Participating Dividend Debentures as follows:

"RECORD OF REGISTRATION

—of—

PARTICIPATING DIVIDEND DEBENTURES

Participating dividend debentures Nos. one to six inclusive, authorized as at the meeting of April 21, 1937, being one participating dividend debenture in the amount of Five Hundred Thousand ($500,000) Dollars, and five participating dividend debentures each in the amount of Twenty-five Thousand ($25,000) Dollars, were on this 30th day of April, 1937, registered in the name of Associated Breweries of Canada, Limited, by the undersigned as secretary of Washmont Corporation, and the

fact of such registration was endorsed on each of said several participating dividend debentures.

O. H. MILLS,
Secretary."

There was offered by plaintiff and admitted, minutes of special meeting of directors of Washmont Corporation held December 10, 1937, containing the following:

"............

"Mr. Sick announced that the purpose of the meeting was to declare a dividend to the stockholders of the Company and to the owners of the Participating debentures of the Company. After discussing a summary prepared by the Company's auditors relative to earnings and expected earnings of the Company for the year, the following Resolutions were unanimously adopted:

"Be it resolved, that whereas, interest at the rate of 3% per annum has been duly paid on the Participating Dividend Debentures of this Company as of November 1, 1937, and accordingly a dividend in the amount of 3% upon the par value of the common stock of the Company may be now declared;

"Now, therefore, be it resolved, that a dividend at the rate of 3% upon the common stock of the Company be paid to stockholders of rec-

ord on December 15, 1937, and distributed on December 20, 1937, and

"Be it further resolved, that there will then remain in the Treasury of the Company a sum in excess of $39,000.00 constituting available net earnings from which dividends may be declared; now, therefore, be it resolved, that said sum so available as net earnings be divided ratably in accordance with the face value of the outstanding debentures of this Company and the par value of the outstanding common stock thereof, the same constituting a 6% [51] dividend upon the par value of such common stock and the face value of such outstanding debentures, and that such distribution be made to such stockholders and debenture holders of record December 15, 1937, and distributed December 20, 1937."

There was offered by the defendant and admitted, minutes of annual meeting of the stockholders of Washmont Corporation held April 15, 1938, containing the following:

"The President called the meeting to order and directed the Secretary to poll the stock present at the meeting. There were present, in addition to the Chairman, Mr. Stephen F. Chadwick and Mr. R. H. B. Ker, representing 25,000 shares of the capital stock.

"The President announced the presence of a quorum, and presented to the meeting a

resume of the Company's business and affairs during the preceding year."

There was offered by the plaintiff and admitted, minutes of special meeting of the Board of Directors held December 29, 1938, containing the following:

"Mr. Sick announced that the purpose of the meeting was to declare a dividend to the stockholders of the Company and to the owners of the Participating debentures of the Company. After discussing a summary prepared by the Secretary relative to earnings and expected earnings of the Company for the year, the following Resolutions were unanimously adopted:

" 'Be it resolved, that whereas, interest at the rate of 3% per annum has been duly paid on the Participating Dividend Debentures of this Company for the year 1938, and accordingly a dividend in the amount of 3% upon the par value of the common stock of the Company may be now declared;

" 'Now, Therefore, Be It Resolved, that a dividend at the rate of 3% upon the common stock of the Company be paid to stockholders of record on December 29, 1938, and distributed on December 29, 1938, and

" 'Be It Further Resolved, that there will then remian in the Treasury of the Company a sum in excess of $15,000.00 constituting available net earnings from which dividends may be declared; Now, Therefore, Be It Resolved, that

said sum so available as net earnings be divided ratably in accordance with the face value of the outstanding debentures of this Company and the par value of the outstanding common stock thereof, the same constituting a 2% dividend upon the par value of such common stock and the face value of such outstanding debentures, and that such distribution be made to such stockholders and debenture holders of record December 29, 1938, and distributed December 29, 1938.' "

The plaintiff then offered, and upon objection the Court refused to receive certain minutes and records of Washmont [52] Corporation, which, so far as material to this appeal, consist of the following:

Minutes of Special meeting of common stockholders of Washmont Corporation held April 11, 1940.

The chair stated that the purpose of the meeting was to consider a proposal to change the capital stock of the corporation by the authorizing of the issuance of preferred shares to be delivered to the owners and holders of the participating dividend debentures heretofore issued by the corportion; that while the company took the position with the Internal Revenue Department of the Department of Treasury of the United States that the holders of participating dividend debentures of the company were in fact stockholders, whose investments were equally at hazard in the success of the corporation

with the capital evidenced by the company's certificates of common stock, that since the program of participating dividend debentures was somewhat unprecedented, it was felt that the true situation would be more evident if in lieu of participating dividend debentures preferred stock certificates were issued.

Resolution was adopted to change Article 5 of the Articles of Incorporation so as to provide that instead of an authorized capital of 50,000 shares of the par value of $1.00 each, all of one class, with the same rights, voting powers, privileges and restrictions. The capital stock shall consist of $1,050,000 divided into common and preferred stock of which the common shall consist of 50,000 shares of the par value of $1.00 each, and the preferred of 1,000 shares of the par value of $1,000 each. The preferred stock to be entitled to receive, if earned, dividends at the rate of 3% prior to payment of dividends on common stock, and the common stock to receive, after payment of such dividends on preferred, a dividend at the rate of 3% after which all remaining available [53] earnings shall be distributed ratably in proportion to the par value in the outstanding preferred and common stock. Such preferred stock shall be redeemable in whole or in part at the option of the Board of Directors upon one month's notice, at the par value thereof plus unpaid dividends due thereon, plus a premium equal to the excess of book value of the then assets of the corporation over the par value of its outstanding common stock, and the outstanding pre-

ferred stock then issued and outstanding ratably apportioned between them; with similar provision for payment upon liquidation. The preferred stock shall have no voting power except on matters reserved to it by statute, nor be entitled to notice of meetings of stockholders.

> "Associated Breweries of Canada, Ltd., hereby enters its subscription for six hundred fifty-four (654) shares of the preferred capital stock of Washmont Corporation and tenders in satisfaction of said subscription Participating Dividend Debentures of said Washmont Corporation in the sum of $625,000 principal in Debentures number 1-6 inclusive, and Participating Stock Dividend Debenture, Series Two, No. 1, for $28,980 principal, and directs that the sum of $20 required to bring its subscription up to $654,000 be charged to participating dividend due and accrued upon said debentures to this date, it being understood that the first dividend to be paid upon said Preferred Stock so subscribed for, to-wit, the dividend to be paid May 1, 1940, will be paid in full without deduction of certificates of preferred stock for said Participating Dividend Debentures and said Participating Stock Dividend Debenture.

Dated this 12th day of April, 1940.

ASSOCIATED BREWERIES OF
CANADA, LTD.

E. G. SICK,
President."

Amendatory Articles of Incorporation filed with the office of the Secretary of State of Washington, April 12, 1940, increasing the capital stock of Washmont Corporation from $50,000 to $1,050,000, and changing Article 5 in accordance with Resolution adopted by the stockholders as above set forth. [54]

Thereupon both parties rested.

The foregoing is all of the material evidence adduced at the hearing before the Court, and material to the statement of points upon which appellant intends to rely herein.

(Signed) H. B. JONES

Attorney for Plaintiff and Appellant.

Copy received this 5th day of Aug., 1942.

THOMAS R. WINTER

[Endorsed]: Filed Aug. 11, 1942.

[55]

[Title of District Court and Cause.]

APPELLANT'S DESIGNATION OF CONTENTS OF RECORD ON APPEAL

The plaintiff above named having taken an appeal from the judgment herein designates the following to be included in the record on appeal:

1. Complaint
2. Amended Answer
3. Opinion

4. Findings and Conclusions
5. Judgment
6. Notice of Appeal
7. Statement of points on appeal
8. Condensed statement of testimony filed herein
9. This designation
10. Order extending time.

(Signed) H. B. JONES

Attorneys for Appellant

Copy received this 6th day of Aug., 1942.

THOMAS R. WINTER

[Endorsed]: Filed Aug. 11, 1942. [56]

[Title of District Court and Cause.]

ORDER EXTENDING TIME

It is hereby stipulated by and between the plaintiff-appellant, by its attorneys, Jones & Bronson, and defendant-appellee, by Thomas R. Winter, Special Assistant to the Chief Counsel for the Bureau of Internal Revenue, that the time for filing the record on appeal and the docketing of the action shall be extended to a date ninety days from the date of first notice of appeal, which date was May 25, 1942, and that an order may be entered granting such extension.

JONES AND BRONSON

H. B. JONES

Attorneys for Plaintiff-Appellant

THOMAS R. WINTER
General Counsel Representative, Bureau of Internal Revenue of Counsel for Defendant-Appellee

Approved and so ordered this 29th day of June, 1942.

JOHN C. BOWEN,
United States District Judge

[Endorsed]: Filed June 29, 1942. [57]

[Title of District Court and Cause.]

CLERK'S CERTIFICATE TO TRANSCRIPT OF RECORD

I, Judson W. Shorett, Clerk of the District Court of the United States for the Western District of Washington, do hereby certify and return that the foregoing Transcript of the Record on Appeal, consisting of pages numbered 1 to 57, inclusive, is a full, true and correct copy of so much of the record, papers, and proceedings in Cause No. 216. Washmont Corporation, a corporation, Plaintiff and Appellant, vs. Thor W. Henricksen, individually and as Acting Collector of Internal Revenue, etc., Defendant and Appellee, as required by the Designation of the Plaintiff-Appellant of the Contents of the record on Appeal. on file and of record in my office at Tacoma, Washington, the same

constituting the Transcript of the Record on Appeal from the Judgment of the District Court of the United States for the Western District of Washington, Southern Division, to the United States Circuit Court of Appeals for the Ninth Circuit.

I do further certify that the original Statement of Appellant of Points and Designation of Record for Printing is transmitted herewith.

I do further certify that the following, is a full, true and correct statement of all expenses, fees and charges incurred and paid on behalf of the Plaintiff-Appellant herein, in the preparation and certification of this Transcript of the Record on Appeal to the United States Circuit Court of Appeals for the Ninth Circuit, to-wit:

Appeal fee	$ 5.00
Clerk's fees for preparing and comparing the aforesaid record	7.50
Clerk's certificate	.50
	$13.00

In Testimony Whereof I have hereunto set my hand and affixed the seal of said Court, at the City of Tacoma, State of Washington, this 20th day of August, 1942.

[Seal] JUDSON W. SHORETT,
Clerk
By E. REDMAYNE,
Deputy

[Endorsed]: No. 10228. United States Circuit Court of Appeals for the Ninth Circuit. Washmont Corporation, a Corporation, Appellant, vs. Thor W. Henricksen, Individually, and as Acting Collector for Internal Revenue for the Western District of Washington, Southern Division, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Western District of Washington, Southern Division.

Filed August 24, 1942.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

United States Circuit Court of Appeals
For the Ninth Circuit
No. 10228

WASHMONT CORPORATION,
a corporation,

Appellant

v.

THOR W. HENRICKSEN, individually and as Acting Collector of Internal Revenue for the Western District of Washington, Southern Division,

Appellee

APPELLANT'S STATEMENT OF POINTS AND DESIGNATION OF RECORD FOR PRINTING

Comes now Washmont Corporation, appellant above named, and for its statement of points upon which it intends to rely on this appeal adopts the statement of points filed by it in the District Court in connection with its notice of appeal and included in the transcript of record prepared and certified by the Clerk of such District Court at page 28 thereof; and appellant designates the entire transcript of record as prepared and certified by the Clerk of said court as necessary for the consideration of this appeal.

H. B. JONES

Attorney for Appellant

Copy received this 18th day of Aug., 1942.

THOMAS R. WINTER

[Endorsed]: Filed Aug. 24, 1942.

No. 10228

IN THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

WASHMONT CORPORATION, a Corporation,
Appellant,

vs.

THOR W. HENRICKSEN, Individually, and as Acting Collector of Internal Revenue for the Western District of Washington, Southern Division,
Appellee.

UPON APPEAL FROM DECISION OF UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF FOR THE APPELLANT

JONES & BRONSON
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Seattle, Washington.

THE ARGUS PRESS, SEATTLE

No. 10228

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

WASHMONT CORPORATION, a Corporation,
Appellant,

vs.

THOR W. HENRICKSEN, Individually, and as Acting Collector of Internal Revenue for the Western District of Washington, Southern Division,
Appellee.

UPON APPEAL FROM DECISION OF UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF FOR THE APPELLANT

JONES & BRONSON
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INDEX

TABLE OF CASES

TEXTBOOKS

STATUTES

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT

WASHMONT CORPORATION, a Corporation, *Appellant*, vs. THOR W. HENRICKSEN, Individually, and as Acting Collector of Internal Revenue for the Western District of Washington, Southern Division, *Appellee*.	No. 10228

UPON APPEAL FROM DECISION OF UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF FOR THE APPELLANT

OPINION BELOW

The opinion of the District Court from which this Appeal is taken is not officially reported, but may be found in 1942 C.C.H. §9302.

JURISDICTION

This action was instituted by the appellant as plaintiff, for the recovery of income taxes alleged to have been wrongfully assessed and collected, under Section 24(b) of the Judicial Code as amended, and as qualified by Section 3772 I.R.C. From a decision adverse

to its claim, after trial by the court without a jury, this appeal is taken under Section 128(a) of the Judicial Code, as amended.

STATEMENT OF THE CASE

The taxes involved were assessed by the Commissioner of Internal Revenue, and collected by the appellee, for the calendar years 1937 and 1938, under the provisions imposing a surtax on personal holding companies (Section 351 of the Revenue Act of 1936, as amended by the Act of 1937, and Section 401 of the Revenue Act of 1938.) The provisions of the Internal Revenue Code, so far as concerns the question here involved, are identical with the provisions of the respective acts, and reference will therefore be made only to the Code. Section 500 I.R.C. imposes a surtax at certain rates upon the net income of every personal holding company. Section 501 I.R.C. defines a personal holding company as any corporation whose income is of a certain character and

> "(2) Stock Ownership Requirement. At any time during the last half of the taxable year, more than 50% in value of its outstanding stock is owned, directly or indirectly by not more than five individuals."

Appellant's income was of the character defined as personal holding company income. The only question involved in this proceeding arises under the stock ownership requirement, it being claimed by the appellant that during the last half of each of the taxable years, more than 50% in value of its outstanding stock was owned directly or indirectly by more than five individuals.

This contention turns upon whether certain securities issued by the appellant, designated as participating dividend debentures, held by Associated Breweries of Canada, Limited (hereinafter called "Associated"), are to be considered as stock or evidence of debt. Appellant's capital structure consisted of 25,000 shares of common stock, par value $1.00 each, all held by one individual, and $625,000 of such participating debentures, all held by Associated, which in turn had several hundred shareholders and whose stock was not owned to the extent of 50% either directly or indirectly by not more than five individuals (R. 30). Appellant claims that the debentures should be classified as stock,and, if so, then the personal holding company tax would not apply. The only question presented upon this appeal is a determination of the nature or character of such securities.

SPECIFICATION OF ERRORS

1. The trial court erred in holding that the issued debentures constituted a debt and not a stock or equity interest (R. 24) and in failing to hold that such securities were not and were not intended to be or create an indebtedness against the appellant, rather than an equity interest at risk in the business, as set forth in Finding 8 (R. 31).

2. In considering the evidence offered in support of appellant's claim, the lower court erred in refusing to receive and consider an offer of proof made by appellant to the effect that when the Revenue Agent's office indicated that it would hold the debentures to be a debt rather than stock, and would

classify appellant as a personal holding company, the appellant and Associated forthwith took steps to cause the debentures to be exchanged for and replaced by an issue of preferred stock (R. 45), and in refusing to receive and consider the minutes and records supporting such offer (R. 72-75). Such evidence was objected to "on the ground it is not relevant to the issues in this case as to what was done later" and sustained by the court "on the time element, particularly" (R. 45).

SUMMARY OF ARGUMENT

The debentures were never intended to create a debt, or to constitute the holder a creditor of appellant, but were intended and should be construed to represent an equity interest in capital at risk in the business, and should therefore be classified as stock for purposes of determining application of the personal holding company tax.

The wording of the debentures is entirely different from that of ordinary bonds or evidences of debt, and is more indicative of a capital investment in the nature of preferred stock. In addition, the circumstances giving rise to the issuance of the debentures and the purpose and intent with which they were created clearly stamp them as capital at risk in the business, which should be treated as stock in applying the personal holding company statute.

More concretely, we shall discuss the above propositions under the following headings:

1. The provisions of the debentures are in themselves indicative of preferred stock rather than a debt.

2. The intent and purpose of the parties established their status as capital at risk in the business.
3. The trial court refused to receive proper and material evidence of purpose, or to give proper consideration to evidence admitted. It's opinion does not recognize the realities of the situation or apply the rules of the decided cases.
4. All of the essential elements of the debentures have been recognized as attributes of preferred stock and the great weight of authority stamps them as stock rather than evidence of debt.

ARGUMENT

1. The Provisions of the Debentures Denote an Equity Interest Rather than a Debt.

We shall deal *seriatim* with the significant provisions of the obligations (R. 64), with incidental reference to their legal aspect, which, however, will be developed more fully under Section 4 of the argument.

The instrument is called a "participating dividend debenture." While the word "debenture" signifies a debt, the qualifying phrase "participating dividend" indicates characteristics peculiar to stock, such as sharing in the assets and receiving a return according to earnings. It is significant that the obligation is not called a bond or a note, and its title is as consistent with an equity interest as a debt.

While the name by which the instrument is called may have a bearing, it is not at all conclusive. "They (the cases) all agree that the question for decision in each case is, not what the payments are called, but what in fact, they are, and if taken as a whole, the

evidence shows a relation of debtor and creditor, the payments made on account of that relation, will be interest, no matter how called, while if taken as a whole, the evidence shows a stockholding relation, the payments made will be dividends, equally no matter how called." *U. S. v. South Georgia Railway* (C.C.A. 5) 107 F. (2d) 3, 39-2 U.S.T.C. §9765.

Angelus Bldg. & Inv. Co., 20 B.T.A. 667.

Appellant "acknowledges itself indebted and promises to pay * * * on or before 20 years from date." This is the most definite and specific indication of a debt to be found in the entire instrument, and taken by itself would support the holding of indebtedness. But it must be considered in connection with all of the other provisions of the instrument, and when so considered it amounts to nothing more in substance than the fixing of a definite date for retirement of the interest represented by the debentures, which is a usual incident of preferred stock and has in many cases been held not to prevent classification of the instrument as stock rather than an evidence of debt.

The undertaking is to pay to "the registered owner," not to bearer or order. The amount to be paid is not definitely ascertainable, but is either the face amount or "such other sum as shall be required for retirement in accordance with the terms hereof." These provisions render the instrument non-negotiable. Rem. Rev. Stat. of Washington §3392-3.

The obligation is made "a lien upon the property and net earnings of the company." However, there was no accompanying mortgage or pledge of specific

property and the evidence shows that it was not supplemented by any such security (R. 54). It is simply a general charge against the company's assets similar to the preference or distributive status generally provided in favor of preferred stock. Considering the further provision that all net earnings of the company are required to be divided currently between the holders of the debentures and of the common stock, making it impossible to build up from earnings any fund or surplus to meet the debentures, it is obvious that they can be ultimately retired only out of capital, in what, from a practical standpoint, will be a liquidation of the company.

Such a provision has been considered and held in many cases not to be inconsistent with the equity character of the obligation, a provision for a lien on the assets being very often an element of preferred stock. In *Spencer v. Smith* (C.C.A. 2) 201 Fed. 647, the certificate provided for a guarantee of dividends and the redemption of the principal on or before 10 years, and as security for such obligation there had been executed and delivered to a trust company a first mortgage lien upon all of its property, yet it was held to be preferred stock and not a debt. See also 124 A.L.R. 1070 and 29 A.L.R. 254, 262.

The debenture provides for a return by way of interest and dividends. The interest is to be 3% but "is only payable out of the net earnings of the company for each fiscal year." This, of course, is wholly inconsistent with the usual characteristics of a debt, on which interest is payable regardless of earnings, and before any such thing as net earnings can be de-

termined. "The interest to be paid to them is not to be paid absolutely, as to a creditor, but only out of net earnings, the same fund out of which the dividends on common stock are to be paid. Though called interest, it is really a dividend, because to be paid on stock and out of net profits." *Warren v. King*, 108 U.S. 389, 27 L.ed. 769.

After payment of such interest, if earned, an equalizing sum shall be paid upon the common stock, and the balance of the annual net earnings must be divided and distributed ratably between them, such distribution being characterized as "participating dividends." Such payments, being dispositions out of net earnings, are in the nature of dividends as defined in Section 115 of the Revenue Act of 1936. See also article 23(b) regulations 94, respecting deductions for interest. cf. *Pacific Southwest Realty Co. v. Comm.* (C.C.A. 9) 128 F. (2d) 815, 42-1 U.S.T.C. §9526, in which securities redeemable at a fixed time, then to be treated and enforced as a debt, but with annual payments or return only out of profits, are held to be stock.

The obligation is redeemable either at maturity or upon notice at an intermediate date by paying the principal, and interest, if earned and unpaid, together with accrued dividends unpaid, "plus a premium equal to the excess of the book value of the then assets of the corporation over the par value of its outstanding common stock and face value of the debentures of this issue then outstanding, ratably apportioned to such common stock and to such debentures." This is not such a provision as is ordinarily, if ever, found

in a bond or a note. Not only is it wholly inconsistent with the notion of a debt, but a literal application of the provision definitely stamps the obligation as being necessarily deferred and subordinate to the claims of all other creditors, because otherwise it would lead to the absurd and impossible result that the debenture holders would take precedence over all other creditors and the latter would be frozen out entirely. It should be noted that the premium must be paid whether upon liquidation, redemption or maturity. Such premium, according to the literal wording of the agreement, absorbs the entire difference between the face or par value of the stock and debentures, and the book value of the company's assets. The debentures would, on the present capitilization, take substantially all of such excess. There would be nothing left for other creditors, if such provisions be given their literal effect.

Even if such provisions would not wholly exclude other creditors they would at any rate seriously impair their position if the debentures constitute a debt. As pointed out above, the requirement of equal distribution of all earnings would prevent the current accumulation of any surplus except possibly from appreciation in value of capital assets (even this is doubtful), so that upon retirement or redemption the company will probably have nothing beyond its original capital assets. If the debentures are considered a debt supported by a lien, as respondent will no doubt contend, they would, by reason thereof, exclude all other creditors; if an unsecured debt, they would at least pro-rate with other creditors. If the debentures,

as a debt, are entitled to enforce the provision for a premium, absorbing the difference between the face of outstanding stock and debentures and the total book value of the company's assets, then even though they should rank and participate with other creditors as to their principal, there would necessarily be a pro-ration, so whether there is a lien or not, the other creditors would lose either all or part of their claims, while the debenture holder might receive more than the par value of its obligation. This is obviously an unreasonable and unsupportable construction. The only reasonable conclusion that can be drawn, and the only practicable interpretation that can be placed on the provisions is that it was assumed and intended that the creditors would come first in any event and required no further consideration, and the debenture holders are necessarily subordinate to other liability. While they have certain preferences and superior rights as against the common stock, these are only differences in equity ownership. They cannot be both a stock and a bond, but must be either one or the other.

Considering all of the provisions as a whole, they differ from and are inconsistent with the usual provisions of indebtedness and in view of the extreme and impossible results of giving them recognition as a debt, the only conclusion that can be logically supported is that they represent equity capital at risk in the business, and should be so considered in the application of the personal holding company statute.

2. Intent and Purpose in Creation of the Debentures.

In determining the character of the instrument the court is not limited simply to its terms but is entitled to consider relevant circumstances and particularly the intent and purpose of the parties in creating it. This court has especially committed itself to the position that in cases of this type "the real intention of the parties is to be sought and in order to establish it evidence *aliunde* the contract is admissible." *Comm. v. Proctor Shop*, 82 F. (2d) 792, 36-1 U.S.T.C. §9203; *Comm. v. Palmer, Stacy, Merrill, Inc.* (C.C.A. 9) 111 F. (2d) 809, 40-1 U.S.T.C. §9465; *Pac. S. W. Realty Co. v. Comm.*, 128 F. (2d) 815, 42-1 U.S.T.C. §9526.

There being no dispute or contradiction in the testimony, this court is not bound by the trial judge's findings of fact and the case is "one for the determination * * * of the legal effect of the facts as the record presents them, clearly, simply and without controversy." *U. S. v. South Georgia Realty* (C.C.A. 5) 107 F. (2d) 3, 39-2 U.S.T.C. §9765.

The review is less restricted here than upon a case decided by the Board, whose findings on the facts are made conclusive by statute, so that the following is even more applicable here:

> "Courts will not weigh evidence nor will they substitute their opinion for that of the Board where there is a conflict in the evidence and the findings of the Board are sustained by substantial evidence. But where there is no conflict in the evidence, the legal conclusions to be drawn therefrom present questions of law, and we will

inquire to ascertain whether the undisputed facts sustain the conclusions of the Board."

Farmer, et al. v. Comm. (C.C.A. 10) 126 F. (2d) 542, 1942-1 U.S.T.C. §9335.

The foregoing is but a specific expression of the general rule applicable in tax cases stated by Mr. Justice Black in *Helvering v. Lazarus*, 308 U.S. 252, 39-2 U.S.T.C. §9793, as follows:

"In the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding."

The undisputed testimony shows the following:

Associated Breweries of Canada, Ltd., is the parent organization, of which various companies incorporated in the United States are offshoots, started after the repeal of prohibition. Mr. Emil G. Sick, the president, and one of the directors of Associated, organized these various United States breweries, in which Associated held substantial interests. The principal of these was Seattle Brewing and Malting Company of which Mr. Sick was also president, and in connection with which he established himself as a resident of Seattle. It was considered desirable to have voting control of these stocks localized and lodged with a citizen of the State of Washington, and Mr. Sick was selected to act for that purpose. The means of accomplishing this was by forming the appellant, Washmont Corporation, with a comparatively small amount of voting common stock, which was issued to Mr. Sick and his nominees in exchange for his stock in the local breweries, and by having Associated turn over the stocks held by it in the subsidiary com-

panies in exchange for an interest which was intended and supposed to be on a par with the common stock except that it would not have voting privileges (R. 43, 56).

The reason they did not represent Associated's interest by an issue of preferred stock was the fear that it might violate restrictions of Washington and Montana with respect to alien land ownership, as the companies, which would then be controlled by Washmont, were the owners of real estate. This was the only reason it was not set up as an authorized capital stock (R. 44). The officers and directors of Associated participated in the planning and setting up of the appellant and it was the intent of all parties (Mr. Ker and Mr. Bronson representing Associated; Mr. Sick representing Associated and Washmont, as well as Seattle Brewing and Malting Co., and the other local companies; and Mr. Chadwick, who organized Washmont) that Associated's interest was to be the same as Mr. Sick's interest represented by the common capital stock, except that it should not be called stock and should not have any voting power, and that it was not considered a debt, but in all respects subject to liabilities to creditors (R. 43, 44, 53, 55 and 60). It was never intended that the debentures would rank with other claims or liabilities, but, on the contrary, it was intended that they should be subordinate to its debts and should constitute capital at risk in the business. This was specifically discussed at the time the corporation was formed, and it was definitely understood by the representatives of both Associated and Washmont that the debentures did not constitute

debts but simply an interest in the business on a par with the common stock, except as to the right to vote (R. 44, 53, 56, 60).

No steps were ever taken to fix a lien upon the assets beyond the debenture itself (R. 54). Shortly after the formation of Washmont it had occasion to borrow money, and in all of its transactions with the bank, the latter was assured and made its loans upon the understanding that the debentures were capital and not a debt (R. 39, 56). It had no other creditors.

Another significant fact, which, however, the trial court refused to consider, is that as soon as the question was raised by the revenue agent about the character of these obligations, the parties immediately took steps to definitely settle their status by converting them into an authorized issue of preferred stock (R. 45, 72).

The court sustained an objection to appellant's offer of proof to this effect, which action is assigned as error upon this appeal. The court said "the objection is sustained on the time element particularly" (R. 45). Just what was meant by this is uncertain, as the only objection was on the ground of relevancy. We appreciate that such action is in a sense self-serving as to appellant, and were it confined to a declaration rather than an affirmative act having substantial consequences, it might be rejected on that ground. Even that objection, however, would not apply to the action taken by Associated in making such readjustment of interest. Such change would be substantially to its detriment, if a creditor, and the fact that it permitted and accepted the change is consistent only with

its position that from the beginning it intended to have nothing more than an equity interest, and is strong proof that it never intended to occupy the position of a creditor. The action has strong probative value from a practical standpoint in support of the understanding covered by the direct testimony that the debentures were in fact an equity interest at risk in the business and not a debt, and should have been received and considered for that purpose.

> "The object of a legal investigation is the elicitation of the truth, and to effectuate such object, all facts are admissible in evidence which afford reasonable inferences, or which throw any light upon the subject matter contested. No competent means of ascertaining the truth should be neglected—much less inhibited; and none are to be decreed incompetent unless such means have been shown by reason and experience to prevent or obscure the truth, instead of discovering it."

Callihan v. Wash. Water Power Co., 27 Wash. 154 at 158.

Even where a contract is not ambiguous, in determining the intent and arriving at a reasonable construction, it is proper to consider the circumstances surrounding the transaction, including the way in which the parties themselves later treated it.

Tholme v. Soundview Pulp Company, 181 Wash. 3, at 21, 22.

Indianapolis Glove Company v. U. S. (C.C.A. 7) 96 F. (2d) 816, 38-1 U.S.T.C. §9235.

But whether the rejected evidence be received or not, the positive, direct and uncontradicted testimony

of the witnesses who participated in and controlled the transaction involving the formation of Washmont and the issuance of the debentures, unequivocably establishes their character as capital at risk in the business and not a debt. Certainly in the face of the facts disclosed by such evidence, no creditor of the company would ever be required to suffer either subordination to or pro-ration with the debentures.

3. The Lower Court Failed to Recognize the Established Facts or Apply the Principles of the Decided Cases.

In its disposition of the case, the trial court avoided and refused to consider the purpose and intent of the parties as established by the uncontradicted testimony as well as the actualities of the situation under which appellant was formed, and the debentures issued. We do not mean that he discredited the testimony of the witnesses, for he accepted and relied upon their statements wherever they fitted into his view of the case and the conclusion he had reached. He could not well have declined to believe them, for the testimony was not only in no wise contradicted, impeached, or inherently improbable, but came from witnesses of the highest character. Mr. Chadwick, who handled the transactions resulting in the organization of Washmont, is a member of the bar of this court (R. 42); Mr. Brygger is president of the Peoples National Bank of Washington (R. 38); Mr. Sick is a substantial businessman (R. 55), and Mr. Hoover, who handled the accounts and returns is the Seattle manager of Price-Waterhouse, Inc. (R. 61). The trial judge apparently accepted their testimony but attempt-

ed to neutralize the portions thereof favorable to appellant and which did not fit into his conclusions by a species of dialectic reasoning which entirely ignored the substantial realities.

The court began by saying that Associated's interest was something other than a legal stock certificate (R. 20). That is true, with respect to name or form, but not as to substance. The witnesses stated that it was desired to avoid having the interest set up as an authorized issue of stock for the reason that this would constitute alien control of Washmont, which might create complications by reason of the ownership of lands in Washington and Montana by local companies, which Washmont in turn controlled (R. 44, 59, 60).

But then the court goes on to discuss the debenture as if it were something that Washmont was endeavoring to induce Associated to acquire, treating Associated as if it were an outsider which Washmont was trying to pursaude to become interested in its business—presumably as a creditor. The court speaks of such inducement taking the form of provision for participation in earnings and assets in return for giving up its vote, and in this connection refers to the certificate holders receiving "a guaranteed interest rate" (R. 20). That is a mistake upon a vital and significant point because the interest was not guaranteed and payable in any event, but to be received only if earned.

In further reasoning along the same line (R. 22) the court indulged in pure speculation of "talking points" held out as inducement to Associated to take the certificates. The court's whole approach to con-

sideration of the subject seemed to be founded upon a strained interpretation and erroneous understanding of the situation, which he viewed as a transaction occurring between strangers dealing at arms length, overlooking the real situation that this was in substance a reorganization promoted and carried out equally, if not more primarily, for the benefit of Associated. It was not being induced or persuaded at all, but on the contrary, was really the moving party seeking to bring about a corporate set up that would enable it to participate in the company without appearing as a record holder of authorized stock.

The court was apparently using this method of reasoning, perhaps unconsciously, to destroy or eliminate the force of the testimony and so disregard everything except the debenture itself. The court nowhere squarely met and decided whether the certificates were actually intended to be a debt or a creditor obligation. Intent, where material, is a fact to be proved by the direct testimony of the parties entertaining it. *Vons Investment Company v. Comm.* (C.C.A. 9) 111 F. (2d) 440, 40-1 U.S.T.C. §9441. When the court was pressed for a direct finding upon the fact of intent, it was avoided with the statement that "I feel that the written instrument has to govern that intention" (R. 25).

The court recognized (R. 22) that the certificates were intended and treated as capital at risk in the business when Washmont dealt with its bank, which was its only creditor (R. 22, 39). On the other hand, said the court, the appellant claimed a deduction of 3% interest paid on the debentures, thus indicating

that it considered them a debt (R. 22, 23), and therefore, by offsetting these two points, reached the conclusion that the testimony should be disregarded entirely. That, we submit, is specious reasoning, which falls short of meeting the fundamental question of intent. Granted that appellant did claim an interest deduction to which it was not entitled, still at the same time it was also claiming that a much larger portion of the payments made on the certificates represented dividends, treated in its tax return as a distribution to stockholders (R. 61), a course which was followed in subsequent years (see R. 62, 69, 71). Even though it made an erroneous claim, it contained no element of estoppel and there is no justification for treating that as conclusive against it. The Commissioner was put on notice of the facts and that the instrument could not be both a debt and stock. It was either one or the other. "It is fundamental that the stock in controversy cannot be both capital stock and loans. Their holders must be either capital stockholders or common stockholders, they cannot be both."

> *Bolinger-Franklin Lumber Company v. U. S.A.*, 7 B.T.A. 402;
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> *Hamlin v. Toledo, St. Louis & K. C. Ry. Co.* (C.C.A. 6) 78 Fed. 664;
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> *Hazel-Atlas Glass Co. v. Van Dyke & Reeves* (C.C.A.) 8 F. (2d) 716 at 719; cert. den. sub. nom. *Van Dyke v. Young*, 269 U.S. 570, 70 L.ed. 417;
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> *Angelus Bldg. & Inv. Co.*, 20 B.T.A. 667.

If appellant is to be judged simply by its claims, it should be recognized that the interest deduction

was more than offset by the other entries and treatment of the distributions as dividends upon a participating equity interest. While these two points might be offset against each other, instead of doing this the court ignored the dividend distribution entirely, and held that the claim for interest deduction should offset all other recognition, treatment, intent or purpose of an equity interest, thereby leaving the court "to determine the nature of the debentures and the intention of the issuer and holders thereof from the writing itself" (R. 24). The whole approach of the trial court to the problem goes around and outside of the fundamental question of intent, while at the same time, upon consideration of the debenture alone, it fails to give adequate consideration to the various provisions that indicate the real nature of the obligation. We repeat again that it ignores the realities; as an example, it is utterly inconceivable that any reasonable or sensible person desiring to maintain a creditor position and to obtain an evidence of a debt, would take such an instrument as this which is non-negotiable, bears a return payable only out of net earnings, when, and if available, gives common stock an equal participating earning or right to distribution, and is not enforceable until a date 20 years in the future, without provision for default or acceleration, even in the event of failure of Washmont to meet its obligations. All practical considerations and reasonable probabilities are against that interpretation. The evidence in this case is against it, and the authorities, when they have had occasion to consider similar situations, have reached contrary con-

clusions, as we shall show in the next section of this discussion.

The two provisions which the court considered significant in determining the obligation to be a debt were the promise to pay, and the lien on the company's property. But the first, as we have shown, cannot rationally be considered an absolute promise either superior or equal to the claims of other creditors, and if considered only as a preference against common stock it is entirely consistent with a preferred stock equity. It will be noted that in *Pacific Southwest Realty Company v. Comm., supra*, the certificate purported to give the holder a claim as for a debt and the right to sue in the event of failure to redeem, yet it was held to be a stock interest.

The provision for a lien which the court stresses particularly was not actually effectuated by pledge or mortgage, and as between the corporation and the common stockholders, it is a perfectly consistent provision for preference, and has been many times held not to be inconsistent with the preferred stockholding status or as conclusive in establishing the status of a debt.

4. The Decisions in Similar Cases.

Although we have already discussed a number of the authorities in specific relation to particular points, we desire now, at the risk of some repetition, to review generally the applicable legal rules:

A great many cases have arisen involving the question of whether a particular evidence of interest constitutes the holder a creditor or a shareholder. These

cases are broadly classifiable in two groups. One group comprises those cases arising in bankruptcy, insolvency or other liquidation proceedings calling for the marshalling of assets, where it is necessary to determine the status of the security owner as against the other holders of debt or interests whose rights depend upon the particular instrument. The other group comprises those cases involving public regulation or taxation as, for instance, claims for the allowance of a deduction for interest in determining corporate net income, which would not be allowable if the payments were dividends.

From these decisions two rules or principles are deducible and well established. The first of these is that the designation of the instrument is not controlling and its real character is to be determined by consideration of all of its provisions, together with other facts and circumstances that may properly be considered. The other, which is substantially a corollary of the first, is that the evidence to be considered is not restricted to the written documents and that evidence of the circumstances, purpose and intent of the parties is admissible. This latter rule is perhaps more often recognized and better established in cases of the second group than of the first where the controversy is between parties to the written instrument, since in the second class of cases the controversy is not between the parties but between one of them and the government, and in such cases the parol evidence rule is not applicable and it is always permissible to show the true facts as between the parties to the instrument even though at variance with its terms.

See: Paul & Mertens, Law of Federal Income Taxation §43.74;

Appeal of E. C. Gatlin, 34 B.T.A. 50 at 54.

This court, in *Commissioner v. Proctor Shop, Inc.*, 82 F. (2d) 792, 36-1 U.S.T.C. §9203, recognized both of these rules, in quoting with approval the opinion of the Board of Tax Appeals in the case under review, as follows:

> "None of the decided cases lay down any comprehensive rule by which the question presented may be decided in all cases, and 'the decision in each case turns upon the facts of that case.' * * * In each case it must be determined whether the real transaction was that of an investment in the corporation or a loan to it. On this the designation of the instrument issued by the corporation, while not to be ignored, is not conclusive, * * * The real intention of the parties is to be sought and in order to establish it evidence *aliunde* the contract is admissible. * * * If the evidence establishes 'that dividends paid are, according to the intent of the parties, in fact interest, and the stock on which the dividends are paid is merely held by the creditor as security it makes no difference what the reason was for paying it in that form'."

As pointed out time after time, there is no general rule by which the question can be determined whether in any particular case the security holder is a creditor or a stockholder. It is recognized as fundamental that

> "the essential difference between a stockholder and a creditor is that the stockholder intends to embark upon the corporate adventure, taking the risks of loss attendant upon it that he may enjoy

the chances of profit. The creditor, on the other hand, does not intend to take such risks so far as they may be avoided but merely to lend his capital to others who do intend to take them."

Warren v. King, 108 U.S. 389, 399.

"While no comprehensive rule may be laid down for distinguishing in all cases between an investment in a corporation and a loan to it, one of the most important considerations is whether the right to share in the assets of the corporation in case of dissolution is subject to the rights of creditors. If subject to such right, there is a strong presumption that the interest in question is that of a stockholder."

Helvering v. Richmond, F. & P. R. R. Co. (C.C.A. 4) 90 F. (2d) 971, 37-2 U.S.T.C. §9353.

In the *Proctor* case, *supra*, the instrument was called "debenture preference stock" but was, nevertheless, held to be an evidence of debt. On the other hand, Fletcher, in Volume 6, §2635, of Cyclopedia Corporations, after stating that the name is not conclusive, says:

"For instance, even though an instrument is styled a 'debenture bond,' it is, in effect preferred stock where, by its terms it is made subordinate to the rights of creditors, the interest is cumulative and payable out of earnings, and, on liquidation or dissolution or final distribution of assets, the said bonds are to be entitled to the whole residue of the corporate assets after the payment of debts."

Probably the most definite and practical test that can be applied is whether or not upon a liquidation the

debenture holder in this case would be entitled to share *pro rata* with other general creditors or would be subordinate to them.

The attitude of the Treasury Department in treatment of excess profits cases and classification of borrowed capital, while not conclusive, is, we think, significant. On this subject Regulations 45, Article 812, provides:

> "Art. 812. Borrowed Capital: Securities. Any interest in a corporation represented by bonds, debentures, or other securities, by whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and cannot be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors."

See also Art. 23(b)-1 of Regulations 94.

This provision, which was considered significant by the Fourth Circuit in *Helvering v. R.F. & P.R.R. Co., supra,* in dealing with the same kind of a case as the present, states what seems to be the best general rule that can be deduced from the cases that the obligation is stock and not indebtedness if it is deferred with respect to the payment of interest and principal to the other rights of general creditors.

In I.T. 3555, C.C.H. 1942 §6371, a ruling is made by the Treasury Department classifying as stock rather than indebtedness certain so-called debentures having many of the characteristics of those in this

case, which, while not entirely applicable, is significant in a number of respects.

See also *Dayton & Michigan R.R. Co. v. Commissioner* (C.C.A. 4) 112 F. (2d) 627, 40-2 U.S.T.C. §9518, involving guaranteed dividends, secured by a mortgage on the property.

Warren v. King, 108 U.S. 389, 27 L. ed. 769, is a leading case on this general subject, having several points of similarity with this case, especially in that return was payable only out of net income, and contains a very good discussion of fundamental principles, particularly by way of definition of the characteristics of capital at risk in the business.

In re Culbertson's (C.C.A. 9) 54 F. (2d) 753, involved the status of preferred stock in liquidation which it was claimed represented indebtedness because with no voting power, a guaranteed fixed yearly rate of return, and provision for the payment of the par value of the shares at a definite date. But this court held that it was the intention of the parties that such certificates should evidence a participation in earnings and that "the fact that it provides for the redemption of the certificates does not constitute the holder a creditor (14 C.J. 417), and the agreement to pay dividends at stated intervals must be construed to be an agreement to pay the same from the profits."

The crux of the matter is whether or not, in the light of the surrounding facts and circumstances, the debenture holder would be entitled to participate with the other creditors and as one of them upon a liquidation. If not, then the mere fact that a time is fixed

for payment is of no significance, since a definite time is often provided for retirement of preferred stock.

In *Armstrong v. Union Trust & Savings Bank* (C.C.A. 9) 248 Fed. 268, the question arose upon a claim filed in a receivership proceeding by the holder of a certificate evidencing an interest in preferred stock. The obligation was transferrable only on the books of the company, bore interest at 7%, was redeemable at any time after five and prior to ten years at a premium of 5%, and after ten years without premium, and in the case of some of the certificates was accompanied by a rider by which the corporation agreed, upon demand of the holder, to pay the obligation evidenced by the stock at par, with accrued interest, at the end of five years. It will thus be seen that except for its designation as preferred stock, the obligation was, if anything, less a participating or shareholding interest than in this case. After noting the rule that the name is not controlling, the court pointed out that in view of the history of the transaction the intent was to constitute the holder of the obligation a contributor to the capital of the company, and in spite of the specific undertaking to discharge the obligation at a definite time, it held the instrument to be stock and not a debt, saying:

> "No doubt they expected to share in whatever dividends were declared on the stock after payment of the stipulated interest, and to await the declaration of such dividends until the earnings of the capital stock would warrant such action. They could not well expect such dividends and

> at the same time claim that their certificates constituted them creditors. Creditors are entitled to no dividends on their demands. What they might get from the company would go in the way of a discharge of the liability, either partially or entirely. The two positions are wholly inconsistent. They must be considered either stockholders or creditors. They cannot be both. Whatever may be the engagement of the company as between its stockholders, it can have no bearing upon the question for determination. From a review of the entire situation we conclude that these certificate holders are stockholders—preferred stockholders, as the certificates indicate—and not creditors." 248 Fed. 268 at 271.

In the bankruptcy case of *Fechheimer Fishel Co.* (C.C.A. 2) 212 Fed. 357, which has become a leading case on the subject, a claim was presented based on a "debenture bond." The bond contained a provision that it should be subordinate to the general business claims of the company and upon liquidation or dissolution of the company or final distribution of its assets, such creditors should be entitled to priority of payment in full over the bond. It was entitled to interest at 8% per annum and such interest was cumulative and upon liquidation, dissolution or final distribution was entitled, after payment of the debts of the company, to the whole residue of the assets. The bond had a definite due date (see page 366). The bond had, in fact, been superseded by a note issued in place thereof on which the claim was directly made, but in passing on the matter the court considered it upon the basis of the nature of the bond. After

referring to the matters above mentioned, the court said:

> "All these features are quite characteristic of stock. They are not at all characteristic of bonds. And we are satisfied that no error was committed by the court below in holding that these so-called 'bonds' were in effect preferred stock." (p. 360) * * * "Assuming that the bond was nothing more than preferred stock, it is necessary to consider whether the fact that it had a definite due date affords any sufficient reason for distinguishing it from stock not so limited in time, and making it necessary to hold that all who became creditors after the due date, or after the date of the first note or the date of the renewal note should be held to have no claim superior to Rothenberg's upon the assets of the corporation. * * * The due date of the bond and the due date of the note are alike immaterial under the circumstances of the case. At the best they only indicated a time when a reduction of the capital stock might have been made under the agreement, but, as the reduction was not made, it may be disregarded" (p. 366).

In *Kentucky River Coal Corporation*, 3 B.T.A. 644, the taxpayer sought a deduction, as for interest, for dividends paid upon its debenture stock during the year. The debenture stock was entitled to 6% return, was retirable with a premium after three years at the option of the company, and was required to be paid off at the end of ten years at par. Dividends were payable only out of surplus profits or earnings, but were cumulative. The Board, after reviewing a number of cases involving similar obligations which had a fixed maturity date, at which time they became due and could be required to be discharged, held "that

the dividends paid by the taxpayer upon its shares of debenture stock outstanding during the year 1919 were not the equivalent of interest paid on indebtedness."

The same question came before the District Court of Kentucky upon a suit for refund involving a different year, entitled *Kentucky River Coal Corporation v. Lucas*, 51 F. (2d) 586, 10 A.F.T.R. 279, affirmed without opinion by the Circuit Court of Appeals for the Sixth Circuit at 63 F. (2d) 1007, 12 A.F.T.R. 356. The District Court said:

> "The entire capital of the plaintiff corporation was represented by the property transferred to it by the five selling corporations, and the debenture stock is just as much reflected in this property as is the common and preferred stock.
>
> "The debenture stock, when issued, was styled 'debenture stock,' and provided that the stipulated dividend of 6 per cent should only be paid out of the surplus profits, earnings, or assets of the corporation, a typical provision as to preferred stock, as distinguished from ordinary indebtedness." * * *
>
> "Nor do I think the unconditional undertaking to redeem the stock at par at the end of ten years destroys its nature as capital stock. The stockholders among themselves undoubtedly had the right to make such an agreement. If its enforcement rendered the corporation incapable of meeting its obligations to those general creditors whose claims were within the $25,000 debt limitation, I have no doubt the courts would hold that the rights of the holders of these debenture shares were subordinate to the rights of these general creditors.

> "I am constrained therefore to agree with the Board of Tax Appeals in its decision involving exactly this same question with the same taxpayer, and reported in 3 B.T.A. 644."

The principal reasons assigned by the lower court for holding the debentures to be a debt were: That they matured at a definite date and recited that they constitute a lien on the property of the company. As to the maturity, that is immaterial, provided they are subordinate to the claims of creditors. It is like an issue of preferred stock which may be retired at a fixed date. In this sense, of course, all stock has a maturity date fixed at the life of the corporation. In addition to cases cited above on this point, we refer to the following:

Finance & Investment Corp. v. Burnet (D.C. App.) 57 F.(2d) 444, 10 A.F.T.R. 1560, holding so-called preferred stock entitled to cumulative 8% dividends and redeemable at the election of the holder, to be stock and not indebtedness and payments thereon not deductible as interest.

Appeal of Dodd, Mead & Company, Inc., 43 B.T.A. 739 at 747, holding certificates represented stock rather than indebtedness, although required to be redeemed at specified times.

Elko LaMoille Power Co. v. Commissioner (C.C.A. 9) 50 F.(2d) 595, 10 A.F.T.R. 53, holding that certificates redeemable at election of the company at a certain time and sold upon representation that they would be redeemed on demand, ratified by the board of directors, constituted stock and not a debt.

Angelus Bldg. & Investment Co., 20 B.T.A. 667,

holding that certificates containing a provision for retirement on which payments were made as interest, were in fact stock and not indebtedness.

As to the provision for a lien, there was no mortgage or evidence of security or priority other than the statement in the debenture certificate which relates to no specific property and in law is absolutely meaningless as to creditors. Several of the cases have involved instruments containing language of that kind used in connection with preferred stock and have considered it of no significance except as to determining rank or preference between the equity holders. Typical of such cases is *Weaver Power Co. v. Elk Mountain Milling Co.*, 69 S.E. 747, holding that certificates of stock reciting that they constituted a preferred lien on the assets of the company were, nevertheless, stock and not a debt, the preference being only as between stockholders.

See also:

Hamlin v. Toledo, St. Louis & K. C. Ry. Co., (C.C.A. 6) 78 Fed. 664;

Dayton & Michigan R. R. Co. v. Comm. (C. C.A. 4) 112 F.(2d) 627; 40-2 U.S.T.C. §9518 (where the lien was put in the form of a mortgage);

Warren v. King, 108 U.S. 389, 27 L. ed. 769;

Spencer v. Smith, 201 Fed. 647, 124 A.L.R. 1070, 29 A.L.R. 254, 262.

As bearing generally on the principles above discussed, see:

Fidelity Savings & Loan Ass'n. v. Burnet (C. of A., D.C.) 65 F.(2d) 477;

Bakers Mutual Co-op Assn. v. Comm. (C.C.A. 3) 117 F.(2d) 27, 41-1 U.S.T.C. §9181;

Brown-Rogers-Dixon Co. v. Comm. (C.C.A. 4) 122 F.(2d) 347, 41-2 U.S.T.C. §9657;

Policyholders National Life Assurance Co. v. Comm., 37 B.T.A. 60;

Ticker Publishing Co., 46 B.T.A. No. 50;

cf. *Jewel Tea Co. v. U. S.*, 90 F.(2d) 451, 37-2 U.S.T.C. §9331.

CONCLUSION

We think it is clear that, even if considered wholly by itself, the debenture in this case is not such an instrument as would ordinarily be drawn or received by a creditor to denote a debt, and that considering all of its terms and provisions it would never rank with the claims of other creditors. When in addition to the language of the instrument itself, there is considered the uncontradicted testimony as to the reason and purposes controlling its issuance, it is apparent that it constituted capital at risk in the business. The action of Associated in accepting a new issue of preferred stock clearly defining that position is significant. The debentures certainly would not rank on a par with other indebtedness of Washmont, and giving due consideration to all of the various terms of the instrument, the significance of which has been stressed by the decided cases, the circumstances surrounding their issuance, and the intent and purpose of those who issued and received them, it is submitted that they should be classified as stock and not a debt and that,

therefore, appellant was not a personal service corporation and is entitled to recovery of the tax here involved.

Respectfully submitted,

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No. 10228

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

WASHMONT CORPORATION, a Corporation,

Appellant,

v.

THOR W. HENRICKSEN, Individually, and as Acting Collector of Internal Revenue for the Western District of Washington, Southern Division,

Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF FOR THE APPELLEE

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INDEX

CITATIONS

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HONORABLE JOHN C. BOWEN, *Judge*

BRIEF FOR THE APPELLEE

OPINION BELOW

The only previous opinion in this case is that of the District Court (R. 19-26) as yet unreported.

JURISDICTION

This notice of appeal (R. 34-37) involves federal income tax for the calendar years 1937 and 1938, paid

by the taxpayer on or about July 8, 1940. (R. 29-30) On July 19, 1940, the taxpayer filed a claim for refund with the appellee as acting Collector of Internal Revenue. (R. 30.) This claim was rejected by the Commissioner of Internal Revenue on December 13, 1940. (R. 30.) More than six months thereafter and on February 19, 1941, the taxpayer instituted an action in the District Court for the Western District of Washington for recovery of taxes paid under the provisions of Section 24, Fifth, of the Judicial Code as amended. (R. 2-6.) The judgment of the court denying the claim was entered March 4, 1942. (R. 33-34.) Within three months and on May 25, 1942, the taxpayer filed a notice of appeal in this Court (R. 34-35) pursuant to the provisions of Section 128(a) of the Judicial Code as amended.

QUESTIONS PRESENTED

1. If "Participating Dividend Debenture Certificates", issued by the taxpayer, were stock does the taxpayer's right to redeem them constitute an "option to acquire stock" within the meaning of Section 354 of the Revenue Act of 1936 and Section 404 of the Revenue Act of 1938 so as to render the taxpayer taxable as a personal holding company?

2. Were "Participating Dividend Debenture Certificates", issued by the taxpayer, stock within the meaning of Section 351 of the Revenue Act of 1936 and Section 402 of the Revenue Act of 1938 so as to exclude the taxpayer from taxation as a personal holding company whose stock was held by not more than five individuals?

STATUTES INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648, as amended by the Revenue Act of 1937, c. 815, 50 Stat. 813, Sec. 1:

> SEC. 352. DEFINITION OF PERSONAL HOLDING COMPANY.
>
> (a) *General Rule.*—For the purpose of this title and of Title I the term "personal holding company" means any corporation if—
>
> * * *
>
> (2) *Stock Ownership Requirement.*—At any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.
>
> * * *
>
> SEC. 354. STOCK OWNERSHIP.
>
> (a) *Constructive Ownership.*—For the purpose of determining whether a corporation is a personal holding company, insofar as such determination is based on stock ownership under section 352 (a) (2), section 353 (e), or section 353 (f)—

(1) *Stock Not Owned by Individual.*—Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners or beneficiaries.

* * *

(3) *Options.*—If any person has an option to acquire stock such stock shall be considered as owned by such person. For the purposes of this paragraph an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

* * *

(5) *Constructive Ownership as Actual Ownership.*—Stock constructively owned by a person by reason of the application of paragraph (1) or (3) shall, for the purpose of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason of the application of paragraph (2) shall not be treated as owned by him for the purpose of again applying such paragraph in order to make another the constructive owner of such stock.

* * *

Sections 402(a) (2) and 404(a) (1) (3) and (5), respectively, of the Revenue Act of 1938, c. 289, 52 Stat. 447, are identical with the above.

STATEMENT

From the findings of the District Court and the undisputed testimony adduced by the taxpayer the relevant facts may be briefly summarized as follows:

Associated Breweries of Canada, Ltd. (referred to herein as Associated) was a Canadian corporation and at no time during 1937 or 1938 was 50 percentum of value of its outstanding stock owned by five or less individuals. (R. 30-31.) Prior to April, 1937, Associated owned the controlling stock interest in several American breweries. (R. 56, 60.) A Mr. Emil G. Sick, a citizen of the United States and president of Associated, also owned stock in these American breweries. (R. 55, 57.) Because ownership of this stock by Associated, a Canadian corporation, prevented local control of these breweries it was thought the ownership was violative of Montana and Washington statutory prohibitions against alien ownership of land and it was decided to divest Associated of this substantial stock ownership. (R. 43, 55, 56, 60.) Accordingly, Mr. Sick organized the Washmont Corporation, the taxpayer, as a holding company in April, 1937. (R. 43-44.) The taxpayer's articles of incorporation authorized 50,000 shares of $1 par value voting stock. (R. 49.)

On organization of the taxpayer Mr. Sick transferred to it stock owned by him in a Seattle Brewing and Malting Company valued at $25,000 and received from the taxpayer 24,800 of its par $1 voting shares. One hundred shares each were issued to two other individuals. (R. 50-51.) Pursuant to the plan to

use the taxpayer holding company as a device to divest Associated of any control of Washington and Montana breweries the taxpayer corporation received from Associated controlling stocks in these American breweries valued at $625,000. (R. 52, 53, 56, 58.) In exchange Associated received the taxpayer's "Participating Dividend Debentures" in the amount of $625,000. (R. 42, 52-53, 66.)

Under these debentures the taxpayer acknowledged indebtedness for and promised to pay the principal sum 20 years from date. The debenture was stated to be a lien on the property and net earnings of the company. Interest on the debenture was payable semiannually at the rate of three per cent per annum solely from net earnings. After the common stock had received a three per cent dividend, available earnings were to be divided between the debentures and the common stock proportionately on the basis of their aggregate par value. On redemption the debentures were entitled to share in any surplus. They were transferable only through the registry books of the corporation. (R. 64-66.) No vote was given the holder. (R. 20.)

In connection with this $625,000 debenture issue the taxpayer did not attempt to secure any increase in

the $50,000 capital stock authorized by its articles of incorporation. (R. 49, 53.) For the tax years 1937 and 1938 the taxpayer claimed interest deductions for interest payments made to the debenture holders in the sum of $12,698.04 and $19,165.21, respectively. (R. 22-23, 61-62.) In dealing with its bank the taxpayer's debentures were represented by it as a stock interest. (R. 22, 39.)

For the years 1937 and 1938 the taxpayer filed income tax returns as an ordinary corporation. (R. 28-29.) Thereafter the Commissioner assessed deficiencies and penalties against it on the ground that it was a personal holding company within the meaning of and subject to the tax imposed by Section 351 of the Revenue Act of 1936 as amended, and Section 401 of the Revenue Act of 1938. (R. 29.) (Since the relevant provisions are identical reference herein will be made only to the Revenue Act of 1936.) The deficiencies and penalties assessed for 1937 were $3,445.26 and for 1938 were $2,680.04. Subsequently the taxpayer paid these assessments with interest. (R. 29.) A minor adjustment was allowed by the Commissioner. (R. 30.) This suit was instituted to recover the balance, some $6,693.98. (R. 6.)

The above facts were developed by the witnesses for the taxpayer in the District Court. In addition

the taxpayer sought to introduce evidence that, after it learned the Bureau of Internal Revenue regarded the debentures as something other than stock, with resultant classification of the taxpayer as a personal holding company, the taxpayer took steps to convert the debentures into preferred stock. This evidence was ruled inadmissible by the District Court. (R. 45.)

The District Court found that the "debentures" were evidence of debt and were so intended on their issue. (R. 31.) Accordingly, since the common stock of the taxpayer was held by not more than five individuals, to-wit, three, and since its income was personal holding company income it was held subject to the tax levied thereon by Section 351 of the Revenue Act of 1936. (R. 29, 31-32.) From the judgment of District Court against it (R. 33-34) the taxpayer has prosecuted this appeal.

SUMMARY OF ARGUMENT

Even if the debentures should be regarded as stock the taxpayer is taxable as a personal holding company. The debentures are redeemable at the taxpayer's option. Under Section 354 of the Revenue Act of 1936 one who holds an option to acquire stock is to be deemed the owner thereof in determining

whether the corporation is a personal holding company. The right of the taxpayer corporation to redeem the debentures constitutes such an option to acquire stock. The debentures therefore, even if considered as stock, will not enlarge the number of the taxpayer's stockholders to more than five. The taxpayer is therefore taxable as a personal holding company if the debentures represent stock.

Actually the debentures do not represent stock. The debenture instrument identifies itself as a debenture rather than a stock with an acknowledgment of indebtedness and a promise to pay the principal sum 20 years from date.

The several circumstances surrounding the issue and its treatment also establish that the debentures were not intended as stock. From a consideration of all the testimony respecting these circumstances the District Court found that the taxpayer's incorporators intended the debenture certificates to represent indebtedness and not stockholding interest. There is ample support for that finding in the record. Hence the fact that the parties intended the debentures to be what they purport to be, i. e., bonds, must be accepted on appeal.

Since the debentures purport to be bonds rather

than stock and since they were so intended it follows they cannot be regarded as stock increasing the number of the taxpayer's shareholders to more than five. The taxpayer was therefore properly held taxable as a personal holding company under Section 351 of the Revenue Act of 1936.

ARGUMENT

I

ISSUANCE OF NONVOTING REDEEMABLE STOCK WILL NOT RELIEVE A CORPORATION OTHERWISE TAXABLE AS A PERSONAL HOLDING COMPANY

Even if the debentures issued by the taxpayer corporation be regarded as stock the taxpayer is taxable as a personal holding company. Its income is concededly personal holding company income. (Br. 2.) The only question therefor is whether the taxpayer's stock was owned by more than five persons within the meaning of Section 352(a) (2) of the Revenue Act of 1936. Since Section 354(a) (1) of this act provides that stock owned by a corporation is to be considered as owned by its shareholders and Associated has several hundred shareholders (R. 55) it would follow that the taxpayer's stock would be owned by more than five persons *if the debentures were ordi-*

nary stock. As will be seen in the following section the debentures were not stock at all. Assuming arguendo that they were stock, however, consideration must be given the effect of their provision that "the debentures of this issue are * * * subject to redemption * * * on any interest payment date [May 1 and November 1 of each year] * * * after the company shall have given one month's notice of the intention to pay and redeem the same, * * *." (R. 66.)

Under Section 354(a) (3) of the Revenue Act of 1936 it is provided that "if any person has an option to acquire stock such stock shall be considered as owned by such person [for the purpose of determining whether a corporation is a personal holding company]." The purpose of this provision, of course was to prevent evasion of the personal holding company tax by issue of stock to others which the five or less guiding spirits of the holding company could acquire during the taxable year by exercise of purchase options retained by them.[1] It is apparent that issuance of redeemable nonvoting stock to others

[1] H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 7-8 (1939-1 Cum. Bull. (Part 2) 704, 709):

Paragraph (3) of subsection (a) provides that if any person has an option to acquire stock such stock may be considered as owned by such person. * * * Under existing law, some individuals try to circumvent the provisions of section 351 by splitting up the

by a corporation having five or less voting shareholders is in substance the same device. To proscribe the first scheme and permit the second would be an invitation to evasion of the tax imposed on personal holding companies not lightly to be attributed to Congress. In outlawing the "option to acquire stock" as a personal holding company tax evasion device Congress, on the contrary, clearly struck at all such schemes.

The term "person", as used in the Revenue Act of 1936 to which the Revenue Act of 1937 is merely an amendment, includes "an individual * * * *or a corporation*". (Section 1001 of the Revenue Act of 1936.) (Italics supplied.) The taxpayer is thus within the provision of Section 354(a) (3) of the Revenue Act of 1936 that "if any person has an option to

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ownership of stock among more than five individuals but giving less than five individuals an option to acquire the stock at any time they desire. For example, five individuals may own 49 per cent of the value of the outstanding stock of a corporation and one of them may have an option to acquire 2 per cent or more in value of the shares. In such a case, they are for all practical purposes in the same situation as if they owned 51 per cent in value of the stock. If the stock which such individual had a right to acquire by option was added to the other shares actually owned by him, there would be a sufficient stock ownership to bring the company within the personal holding company stock ownership test. The amendment proposed by your committee adopts such a rule.

acquire stock such stock shall be considered as owned by such person". That a right in a corporation to acquire its stock is an option to acquire stock is evident. The requirements in the debenture that such acquisition take place on one of two interest payment dates each year and that notice must be given before such acquisition does not change the character of the option. If the debentures were stock then for purposes of determining whether the taxpayer is a personal holding company the taxpayer corporation is to be regarded as the owner of this "stock".

This "ownership" of this "stock" by the taxpayer under Section 354(a) (3) thus prevents it from escaping classification as a personal holding company. Section 354(a) (5) of the act provides that "stock constructively owned by a person by reason of the application of paragraph * * * (3) shall, for the purpose of applying paragraph (1) * * *, be treated as actually owned by such person; * * * ". The corporation is therefore to be treated as the actual owner of the "stock" for purposes of applying Section 354(a) (1). Under Section 354(a) (1) "stock owned, * * * by * * * a corporation, * * * shall be considered as being owned proportionately by its shareholders, * * *." The debentures in question must therefore be deemed under the statute to be the prop-

rty of the taxpayers' three common stockholders.[2] Thus the taxpayer's stock is, within the meaning of the Act, owned by five or less individuals, to-wit, three, and hence it is taxable as a personal holding company.

The only point of vulnerability in this analysis is the assumption the debentures constitute stock. If they do not constitute stock, however, it is equally clear the taxpayer has five or less shareholders and is taxable as personal holding company.

II

AS EVIDENCES OF DEBT THE DEBENTURES WERE NOT SHARES OF STOCK

The taxpayer concedes (Br. 2-3) that unless the debentures issued by the taxpayer and held by Associated are shares of stock then the taxpayer's stock is held by not more than five persons and it is taxable as a personal holding company under Section 351 of the Revenue Act of 1936. These debentures clearly did not represent stock.

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[2] The purpose of Section 354(a) (3) is to eliminate as shareholders those holding stock subject to an option. See fn. 1, *supra*. Neither Associated nor its stockholders can be counted as the taxpayer's shareholders of this redeemable stock for this reason.

The security was classified as a "Participating Dividend Debenture" by the taxpayer in the first instance. The term "debenture" has a clear and well known meaning, i. e., an instrument of indebtedness, a bond. Webster's New International Dictionary (1933). That this designation of the instrument by the taxpayer as a debt is to be given great weight is settled. *Parisian, Inc. v. Commissioner* (C.C.A. 5th), decided November 10, 1942 (1942 Prentice Hall, par. 63028); *Commissioner v. O.P.P. Holding Corp.*, 76 F. (2d) 11 (C.C.A. 2d). See also concurring opinion of Judge Healy in *Pacific Southwest R. Co. v. Commissioner*, 128 F. (2d) 815 (C.C.A. 9th). While participation in dividends may be an attribute not common to corporate bond issues, this attribute is simply an addition to and does not purport to destroy the fundamental nature of the debenture as a corporate debt. This is made clear by provisions of the debenture itself. Therein the taxpayer corporation "acknowledges itself indebted and promises to pay to the registered owner hereof, on or before twenty years from the date hereof, or on a date to be fixed as hereinafter provided and for the retirement of this debenture, the sum of * * *." It is further provided that "this debenture constitutes a lien upon the property and net earnings of the company and the company hereby charges with the payment of its under-

taking herein all of its property whatsoever and wheresoever, both present and future". (R. 64-65.)

These provisions establish that the security was properly classified by the taxpayer in the first instance as a debenture rather than a stock. The promise to repay the principal sum at a definite maturity date constitutes well nigh, if not, conclusive evidence that the debenture is an evidence of indebtedness rather than a stock. This Court has so held on numerous occasions. *Commissioner v. Palmer, Stacy-Merrill, Inc.*, 111 F. (2d) 809, 810; *Commissioner v. Proctor Shop*, 82 F. (2d) 792, 795; *Elko Lamoille Power Co. v. Commissioner*, 50 F. (2d) 595, 597. Accord: *United States v. South Georgia Ry Co.*, 107 F. (2d) 3 (C.C.A. 5th); *Commissioner v. Schmoll Fils Associated*, 110 F. (2d) 611 (C.C.A. 2d); *Brown-Rogers-Dixson Co. v. Commissioner*, 122 F. (2d) 347 (C.C.A. 4th). Although this Court held a maturity date ineffective to constiute a security a debt in *Pacific Southwest R. Co. v. Commissioner*, 128 F. (2d) 815, it was because the security was styled preferred stock and intended as such—persuasive identification marks absent here.

In addition to a promise to repay the principal sum at a definite maturity date it will be noted that the debenture is stated by its terms to be a lien on the

corporate property. Entirely apart from the validity of such a lien this provision, designed to give Associated priority over subsequent creditors, is additional evidence the debenture was intended as evidence of indebtedness. Actually it is clear under Washington law that as against creditors with notice this lien would have been valid as an equitable lien so as to give Associated a claim paramount to such creditors. *American Sav. Bank & Tr. Co. v. Lawrence*, 114 Wash. 198, 194 Pac. 971; *Farmers State Bank of Lind v. McCully*, 133 Wash. 364, 233 Pac. 661; *Spiers v. Jahnsen*, 143 Wash. 297, 255 Pac. 117. Accord: *Walker v. Brown*, 165 U. S. 654. For extensive citations supporting this general principle see Liens, 33 Am. Jur., § 19, p. 428. That such a lien might not be valid if the debenture had been classified on the taxpayer's balance sheet and registered with the State of Washington as preferred stock (Cf. *Spencer v. Smith*, 201 Fed. 647 (C.C.A. 8th), cited by the taxpayer (Br. 7)) is not at all persuasive of its invalidity when incident to a debenture called such. This lien clearly establishes the debenture holder as a creditor.

Against these provisions above referred to the taxpayer points to the fact that interest on the debentures was payable only out of earnings. Our con-

cern is, of course, with the ultimate character of the debenture, not the nature of the payments thereon—a consideration that suggests caution in complete reliance on decisions concerned with the nature of payments as interest or dividends. Admittedly, by and of itself, provision for distributions solely out of earnings suggest a stock interest. As an isolated attribute it does not compel that conclusion, however, when in company with others that reveal the security as an evidence of indebtedness—its title as a bond and a promise therein to pay the principal sum at a certain maturity date. Cf. *Commissioner v. Proctor Shop*, 82 F. (2d) 792 (C.C.A. 9th) (interest there was subordinated to creditor claims but debenture preference stock was held a debt); *Commissioner v. O.P.P. Holding Corp.*, 76 F. (2d) 11 (C.C.A. 2d) (interest could be postponed by the corporation but the bond was held an indebtedness); *Commissioner v. J. N. Bray Co.*, 126 F. (2d) 612 (C.C.A. 5th) (interest was "cumulative" but the security was held to be a bond).

The best illustration of this proposition that dependence of interest on earnings will not alone convert an instrument of indebtedness into stock is the income bond, a security most certainly not regarded as a stock interest. In *Pacific Southwest R. Co. v. Commissioner*, 120 F. (2d) 815, this Court held pay-

ments from earnings to be dividends when made on a certificate styled "preferred stock" and intended as a stock issue.[3] As Judge Healy's concurring opinion observed (p. 819):

> If they had been denominated "bonds" rather than preferred stocks, I apprehend that nobody would contend that they were not true evidences of debt or that the returns paid thereon were anything other than interest.

The taxpayer argues as well that provisions in the debenture entitling it to a proportionate share of surplus on retirement stamps the debenture as a stock. It is significant that Associated did not assume any risk of loss so this right might well be regarded as a premium for making the loan. The taxpayer urges, however, that the parties could not have intended this species of "after-acquired-property clause" to operate to the prejudice of other creditors and that the debenture as a whole should therefore be treated as no

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[3] It is noteworthy that Article 23 (b)-1 of Regulation 94, issued under the Revenue Act of 1936, and the identical Regulations under the Revenue Act of 1938, classify as dividends "so-called interest on preferred stock". No such provision is made with respect to interest on debentures.

It may be suggested as well that interest is ordinarily paid from earnings. It cannot long be paid otherwise in the usual situation. That payments are made from earnings in fact does not, however, convert interest into a dividend.

debt but as an equity interest. That this provision might prejudice other creditors to the extent enforceable as a secured or unsecured debt may be conceded. The debentures clearly provide however for that result. The assertion that they could not have been so intended simply begs the question.

From the various provisions in the certificates, their classification as debentures, the acknowledgment therein of indebtedness, the promise to pay the principal sum at a certain maturity date and statement that the debenture constituted a lien on the corporate property, it is clear that on their fact these debentures are evidences of indebtedness rather than shares of stock. The only question remaining is whether any extraneous circumstances indicate they were intended as anything else.

Consideration may first be given the circumstances surrounding issuance of the debentures. The taxpayer was organized in order to provide "local control" for certain operating breweries in which Associated, a Canadian corporation, owned substantial amounts of stock. (R. 56.) Mr. Sick, president of the taxpayer and of Associated as well, testified that this desire for "local control" was prompted by a well grounded fear that Washington and Montana statutes prohibiting alien ownership of land required local con-

trol. (R. 60.) By their terms these statutes forbid aliens to control or own a majority of the capital stock of a corporation owning land. [3A] Associated's control over stock in Montana and Washington breweries might have been divested by issue to it of nonvoting preferred stock of the taxpayer holding company in exchange for these brewery stocks. That possibility

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[3A] The Washington statutory prohibition against alien ownership of land is found in Remington's Revised Statutes of Washington, Secs. 10581 and 10582:

SEC. 10581. *Aliens—Rights and disabilities—Definitions.* In this act, unless the context otherwise requires:

—(a) "Alien" * * * does include * * * all corporation * * * a majority of whose capital stock is owned or controlled by aliens * * *;

* * *

(c) "Land" also includes any share or interest in a corporation or other organized group of persons deemed an alien in this act which has title to land either heretofore or hereafter acquired;

(d) To "own" means to have the legal or equitable title to or the right to any benefit of;

* * *

SEC. 10582. *Aliens—Restrictions as to land.* An alien shall not own land or take or hold title thereto. * * *

The Montana statute is similar. Revised Code of Montana (1935), Sec. 6802.

It is noteworthy that these statutes are directed at alien majority control *or* ownership of a corporation's capital stock. This perhaps explains why debentures rather than preferred stock were issued.

was considered by Mr. Sick and his colleagues, including an attorney, but preferred stock was rejected for the reason that "in compliance with the law something other than preferred stock might be required." (R. 60.) In other words it was thought that Associated must be divested of ownership of this stock in the American breweries. Accordingly the taxpayer's debentures were issued as evidences of debt rather than as stock. This circumstance is persuasive the parties intended the debentures to be evidence of debt rather than stock. Cf. *Pacific Southwest R. Co. v. Commissioner*, 128 F. (2d) 815 (C.C.A. 9th), where an intention to escape taxation by issuing stock was held persuasive that a stock issue was intended.

A further circumstance indicating the parties' intention is the fact that at the time the $625,000 debentures were issued the taxpayer's authorized capital stock was only $50,000. (R. 73.) If the debentures were stock they would have been void as unauthorized stock. Washington Constitution, Art. 12, Sec. 6; *Scoville v. Thayer*, 105 U. S. 143; *Hobson v. Marsh*, 69 Wash. 326, 124 Pac. 912; Fletcher Cyclopedia Corporation (Perm. Ed.), Sec. 5144.

The parties certainly did not intend the issue of a security in a form that would have made it invalid. That they fully appreciated the necessity of increasing

their authorized capital stock had the debentures been stock is established by the consulting attorneys' testimony that the debentures were not drawn as stock "in the sense of represented stock on file with the Secretary of State.". (R. 44.)

Still another circumstance persuasive that the parties regarded the debenture as a bond rather than a stock is the fact that for the tax year here involved the interest paid on the debentures was claimed and allowed as a deduction on the taxpayer's income tax returns as interest on indebtedness. (R. 22-23, 61-62.) This circumstance is entitled to weight on the question of the classification of the debenture. *Helvering v. Richmond, F. & P. R. Co.*, 90 F. (2d) 971 (C.C.A. 4th).

Against the foregoing circumstances reenforcing the view that the parties intended the debenture to be evidence of a debt rather than stock the taxpayer points first to testimony by its witnesses that the debentures were not regarded by it or by Associated as giving the latter a claim paramount to general creditors. It is not at all clear that subordination of a bondholder's claim to general creditors would rob him of a creditor's status. In *Commissioner v. Proctor Shop*, 82 F. (2d) 792, this Court held the contrary.

Apart from that, however, little weight can be attached to this testimony in light of the fact that no adverse interest of Associated with relation to general creditor claims is presented by this proceeding. In view of the explicit provisions in the debentures making them debts and secured debts at that, there is basis for considerable doubt, moreover, whether general creditors with notice of the debenture provisions could assert priority over the holder thereof. See Washington cases cited, *supra.*

The testimony that the taxpayer represented to its banker that the debentures were stock is likewise unconvincing, as the District Court observed. (R. 22-24.) This evidence simply establishes a self-serving vacillation on the part of the taxpayer. When income taxes were to be computed debenture interest was treated as deductible interest on indebtedness. When money was to be borrowed the debentures were regarded as venture-sharing stock investments.

Finally the taxpayer refers to evidence ruled inadmissible by the District Court to the effect that, after being apprised of its probable liability to taxation as a personal holding company because the debentures were not stock, the taxpayer's directors saw the error of the course they had pursued and determined

to replace the debentures with preferred stock. (R. 45.) As a self-serving act after the issuance of the debentures this evidence was not relevant. This Court has previously pointed out that it is the intention at the time of issue that is important in determining the nature of the security—not some subsequent intention. *Elko Lamoille Power Co. v. Commissioner*, 50 F. (2d) 595, 597; *In re Culbertson's*, 54 F. (2d) 753, 758. As a matter of fact this evidence seems actually to represent a confession that the debentures as issued did not constitute stock, any declaration to the contrary notwithstanding. (R. 72-74.) It is noteworthy that the preferred stock issued to replace the debentures was covered by an increase in the authorized capital stock of the taxpayer and that it contained no maturity date or promise to pay the principal amount as a debt. (R. 73-74).) It might be that this offered testimony should have been admitted as a declaration against interest. The taxpayer was certainly not prejudiced by its exclusion.

Consideration of all of the foregoing testimony requires the conclusion that the preponderance of the evidence establishes the parties intended the debentures to be something other than stock at the time of their issue, i.e., evidences of indebtedness. The question of the parties' intention is of course a matter of

fact as the taxpayer concedes. (Br. 18.) The District Court found on the basis of the testimony adduced before it that "plaintiff's incorporators at the time of the issuance of the debenture certificates intended them to represent indebtedness of the plaintiff and not legal stockholder interest in plaintiff; that by the written terms of the certificates themselves, they created and were intended to create an indebtedness against the plaintiff corporation rather than a stockholder's interest therein". That there is evidence in the record to support this finding is clear from the foregoing review. The fact that the extraneous circumstances show that the debentures were not intended as stock must therefore be accepted as conclusive by the appellate court. *United States v. Jefferson Electric Co.*, 291 U. S. 386, 407; *Wells Fargo Bank & Union Trust Co. v. McLaughlin*, 78 F. (2d) 934, 936 (C.C.A. 9th); *United States v. Gamble-Skogmo*, 91 F. (2d) 372 (C.C.A. 8th). The taxpayer's suggestion (Br. 11) that the findings of the District Court are not to be accorded the respect given those of the Board of Tax Appeals has no support in the decided cases and is not entirely convincing in and of itself. It is noteworthy that this Court, in attaching weight to the intention of the parties in determining the nature of a security as a bond or stock for tax purposes has in all

cases accepted the lower tribunal's findings on the factual question of intent. *Elko Lamoille Power Co. v. Commissioner, supra; Commissioner v. Proctor Shop, supra; Commissioner v. Palmer, Stacy-Merrill, Inc., supra; Pacific Southwest R. Co., supra.*

Since the debentures on their face are not stock but evidences of indebtedness and since the parties intended then so to be, it is clear they cannot be regarded as stock for the purpose of relieving the taxpayer from classification as a personal holding company. This conclusion is reeinforced by consideration of the nature of the burden of proof resting on the taxpayer.

The Commissioner determined that the taxpayer was taxable as a personal holding company and his determination is presumptively correct. In order to disturb that determination it was for the taxpayer to clearly demonstrate that the debentures were stock. To show that the debentures had some characteristics of stock would not satisfy this burden of proof or the requirement of the statute. The taxpayer was bound to prove that the debentures actually were stock. In this connection it is significant that Section 354(b) of the Revenue Act of 1936 provides that securities convertible into stock cannot be considered as stock if

the effect is to remove the corporation from classification as a personal holding company. The committee report on this provision explains that "debentures" with conversion privileges fall in this group.[4] Hence it is abundantly clear that Congress did not intend "debentures" without conversion privileges to be regarded as stock.

At best the taxpayer adduced some evidence tending to indicate the debentures were bonds with some stock characteristics. In order to escape classification as a personal holding company, however, the taxpayer was bound to clearly establish the debentures were stock. Hence the decision of the District Court that the taxpayer had failed in its proof was correct.

The decisions relied on by the taxpayer are all distinguishable from the instant case.

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[4] H. Rep. No. 1546, 75th Cong., 1st Sess., p. 10 (1939-1 Cum. Bull. (Part 2) 704, 710), states:

The reason for this rule [that convertible securities may be counted to make the corporation a personal holding company but not otherwise] is that it appears that the real owners of certain of these incorporated pocketbooks may own bonds, debentures, or other corporate obligations which contain provisions under which they may be converted into stock. Without such a rule, it might be possible for the company to escape classification as a personal holding company by having its stock held by more than five individuals and at the same time having the interest of the real owner represented by convertible securities.

Representative of these cases is this Court's recent decision in *Pacific Southwest R. Co. v. Commissioner*, 128 F. (2d) 815. The security there involved was properly classified as stock for it was styled "preferred stock" by the issuing corporation and extraneous circumstances showed the parties intended that it should be stock. All of the other decisions cited by the taxpayer where securities were classified as stock involved one or both of these factors. It is the absence of those factors that requires classification of the taxpayer's debentures as evidences of indebtedness in this case.

A case similar to the present one in many respects is that of *Commissioner v. O.P.P. Holding Co.*, 76 F. (2d) 11 (C.C.A. 2d). There the taxpayer, a holding company, acquired all of an operating company's stock and issued in exchange therefor 1,000 shares of $100 common stock and $250,000 of its "debenture bonds". The taxpayer's authorized capital stock was only $20,000. The debentures had a definite maturity date and drew interest at eight per cent but interest payments could be postponed by the corporation. The debentures were subordinated to the claims of general creditors. The court held these debentures to be evidences of indebtedness and the payments thereon to be interest. The taxpayer's classi-

fication of the security as a bond and the presence of a maturity date were the factors that prompted this decision. Cf. *Commissioner v. Proctor Shop*. 82 F. (2d) 792. (The facts are very similar and this Court held "debenture preference stock" evidenced indebtedness.) So also must it be concluded here that the taxpayer's debentures were evidences of indebtedness rather than of stock.

In the event this Court should hold that the taxpayer is not taxable as a personal holding company it would follow that the taxpayer was not entitled to the deductions for interest on the debentures in the amount of $50,000 and $31,250 allowed for the tax years 1937 and 1938, respectively. As pleaded in the defendant's answer, therefore, the plaintiff's recovery in that event should be reduced by the amount of income and excess profits taxes to this deduction. (R. 17-18.)

CONCLUSION

The decision of the District Court was correct and should therefore be affirmed.

Respectfully submitted,

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Assistant Attorney General.

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WILLARD H. PEDRICK,
Special Assistants to the Attorney General.

J. CHARLES DENNIS,
United States Attorney

HARRY SAGER,
Assistant United States Attorney

THOMAS R. WINTER,
Special Assistant to the Chief Counsel.

No. 10233

United States
Circuit Court of Appeals
For the Ninth Circuit.

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Appellant,

vs.

W. BRAICKS and J. G. MOLZ, Liquidating Trustees of Pommerelle Company, Inc., a Corporation,

Appellees.

Transcript of Record

Upon Appeal from the District Court of the United States for the Western District of Washington, Southern Division

ROTARY COLORPRINT, 590 FOLSOM ST., SAN FRANCISCO 60-10-13-42

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

Index Page

Index Page

Index Page

Witnesses for Plaintiffs:

Index Page

ATTORNEYS OF RECORD

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Attorneys for Defendant-Appellant.

In the District Court of the United States for the Western District of Washington, Southern Division.

No. 189

W. BRAICKS and J. G. MOLZ, liquidating trustees of POMMERELLE COMPANY, INC., a corporation,

Plaintiff,

vs.

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Defendant.

COMPLAINT

Comes now the plaintiff and for its cause of action against the defendant alleges:

I.

That the Pommerelle Company, Inc., at all times hereinafter mentioned was a corporation organized, existing and doing business under and by virtue of the laws of the State of Washington; that it was legally dissolved under the laws of the State of Washington on the 8th day of April, 1938; that the plaintiffs, W. Braicks and J. G. Molz, were the duly elected and qualified liquidating trustees of said corporation, this cause of action thereby vesting in them under the laws of the State of Washington. The corporation's principal place of business and the residence of each plaintiff is within the

judicial district of the above-entitled court. Each plaintiff and the said corporation is and was a citizen of the United States and each has at all times borne true allegiance to the government of the United States and each has not in any way voluntarily aided, abetted, or given encouragement to rebellion against the United States. Plaintiffs are justly entitled to the amount herein claimed from the United States, and no assignment or transfer of this claim, or any part thereof, or any interest therein has been made. [1*]

II.

The defendant at all times hereinafter mentioned was and still is the acting Collector of Internal Revenue of the United States for the collection district of Washington, having an office and residing at Tacoma, Pierce County, within the above-entitled district, and the said defendant now is a citizen of the State of Washington, Pierce County therein.

III.

For the calendar year ending December 31, 1937, the said corporation made a return and paid to the said defendant any and all income and excess-profits taxes due to the defendant or to the United States of America under the provisions of the 1936 Revenue Act.

IV.

During 1937 and before September 30, 1937, the said corporation employed the firm of Harold L.

*Page numbering appearing at foot of page of original certified Transcript of Record.

Scott & Company, Certified Public Accountants, to audit their books and provide professional accounting services necessary to the proper operation and functioning of the business preliminary to the corporate liquidation. The said firm of accountants charged a fee of $675.00 for the said services, which constituted reasonable compensation for the services rendered and which fee was paid by the corporation. The corporation thereupon reported the said expenses in its income tax return for the said year as a deduction from income, being reasonable and necessary expenses directly related to the corporation's business.

V.

A meeting of the stockholders of Pommerelle Company, Inc., duly and properly called, was held in the company's office September 30th, 1937. The stockholders thereupon passed a resolution appointing the plaintiffs herein as trustees to [2] wind up and liquidate the assets and affairs of the said company, the said liquidation to be a voluntary liquidation and dissolution of the corporation out of court in accordance with the laws of the State of Washington. Pursuant to a call issued by the said liquidating trustees in accordance with provisions made at the meeting of the stockholders held on September 30th, a special meeting of stockholders was held on October 4th, 1937. All stockholders of the company were present in person or represented by proxy. The said meeting of October 4th was held subsequent to the liquidation and distribution of the assets and affairs of the corporation made to the

stockholders of record in the amounts herein set forth, namely,

Stockholder	Amount of Liquidation
A. Vanderspeck	$12,284.68
W. Braicks	10,237.23
J. G. Molz	8,804.02
Eleanor Cisterer	7,166.05
August Bushmas	6,142.34
Fred W. Wonn	4,094.89
Gilbert Kroll	2,047.45
J. Tangley	2,047.45
C. S. Leede	1,023.72
William D. Leede	2,047.45
Dorothy Leede	2,047.45
Eleanor M. Leede	2,047.45
E. A. Hulitz	1,433.21
	$61,423.39

A report of the said liquidation and distribution was made by the said trustees to the special meeting of stockholders. A resolution was thereupon unanimously adopted approving the action of the said trustee and the liquidation and distribution of assets accomplished and completed by them.

VI.

The total sum of the said distribution in liquidation, namely, $61,423.39, was reported by the corporation in its income tax return for the said year as a dividend paid credit under Section 27 of the 1936 Revenue Act, the stockholders [3] having received their respective shares of the said distribution without restriction and in complete cancellation of all stock owned by them. The Internal Revenue Agent disallowed the said dividend paid credit,

which disallowance resulted in a deficiency assessment in the amount of $7,187.26 as surtax on undistributed profits under Section 14 of the 1936 Revenue Act.

VII.

The deduction made by the taxpayer for the expense of employing the firm of Harold L. Scott & Co., Certified Public Accountants, was disallowed by the Internal Revenue Agent, (which disallowance resulted in an additional assessment of excess-profits tax in the amount of $82.00.

VIII.

That on or about January 16, 1940, the defendant, acting under the instructions of the Commissioner of Internal Revenue, notified the corporation that it was liable for a further assessment under the provisions of the said section of the said Act in the sum of $7,346.34 of income taxes and $144.62 of excess-profits tax, making a total deficiency assessment of $7,490.96. Thereafter, acting under the authority of the Commissioner of Internal Revenue, the defendant required the plaintiffs, the liquidating trustees, to and thereupon they did pay to the defendant the sum of $7,490.96 in payment of the said deficiency assessment, and $918.89 as interest thereon from March 15, 1938. On or about April 9, 1940, plaintiffs filed with the defendant for transmission to the Commissioner of Internal Revenue a claim for refund and repayment of the said amount, a full, true and correct copy of which

claim is hereto attached, marked Exhibit "A" and by reference made a part hereof. No allowance or disallowance of such claim or other action of any nature with regard thereto has been made by the Commissioner of Internal Revenue since the date of filing thereof.

Wherefore, plaintiff prays for judgment against the [4] defendant in the sum of $8,338.98, together with interest thereon from the 9th day of April, 1940, at the rate of 6% per annum until paid, together with its costs and disbursements herein.

GEORGE KINNEAR,

Counsel for Plaintiff. [5]

EXHIBIT A

Form 843
Treasury Department
Internal Revenue Service
Revised June 1930

CLAIM

To be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

Refund of Tax Illegally Collected.

Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

Abatement of Tax Assessed (not applicable to estate or income taxes).

Collector's Stamp (Date received)—

State of Washington,
County of King—ss.

Type or Print

Name of taxpayer or purchaser of stamps—Pommerelle Company, Inc.

Business address—716 Dearborn Street, Seattle, Washington.

Residence—

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed—Tacoma, Washington.

2. Period (if for income tax, make separate form for each taxable year) from Jan. 1, 1937, to 12/31/, 1937.

3. Character of assessment or tax—Income and excess profits tax.

4. Amount of assessment, — $7490.96; Int. $918.89; dates of payment—April 1, 1940.

5. Date stamps were purchased from the Government—

6. Amount to be refunded—$8409.85.

7. Amount to be abated (not applicable to income or estate taxes)—$..........

8. The time within which this claim may be legally filed expires, under Section 322(b)(1) I.R.C. on April 1, 1942.

The deponent verily believes that this claim should be allowed for the following reasons:

The above assessment was the result of disallowance by the Commissioner of Internal Revenue of a dividend-paid credit, returned by the taxpayer, in the amount of $61,423.38, this resulting in the assessment of a surtax on undistributed profits in the sum of $7187.26.

On or about October 4, 1937, taxpayer distributed in final liquidation of its entire assets, specifically including its current net income, assets in the amount of $61,423.38, including the amount set forth above, which was returned as a dividend-paid credit. The stockholders of taxpayer received their respective shares of the said distribution without

restriction and in complete cancellation of all stock owned by them.

A portion of the assessment was based upon the disallowance of the deduction of certain expenses totalling $675.00. These were in their entirety expenses relating to the auditing and similar professional services needed in the winding up and liquidation of the company. They were reasonable and necessary expenses directly related to the business of the taxpayer, and thus deductible.

Sworn to and subscribed before me this 4th day of April 1940.

E. A. NIEMEIER,
Notary Public.

[Signed] POMMERELLE COMPANY, INC.,
By W. BRAICKS,
President.
W. BRAICKS,
Liquidating Trustee.
J. G. MOLZ,
Liquidating Trustee.

(See instructions on reverse side)

CERTIFICATE

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax: Character of assessment and period covered, List, Year, Month, Account No. or Page, Line, Amount assessed $......, Total $.........

Paid, Abated, or Credited Date, Amount, Total $.........

Claim No.—

I certify that the records of this office show the following facts as to the purchase of stamps:

To whom sold or issued, Kind, Number, Denomination, Date of sale or issue, Amount $—.

If special tax stamp, state: Serial number, Period commencing—.

....

Collector of Internal Revenue.

....

(District)

Claim examined by—

....

Claim approved by—

....

Chief of Division.

Amount claimed.... $—

Amount allowed.... $—

Amount rejected.... $—

Committee on Claims

....

....

....

INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

[Endorsed]: Filed Oct. 22, 1940. [6]

[Title of District Court and Cause.]

ANSWER

The defendant, in answer to the complaint, alleges as follows:

FIRST DEFENSE

1. The complaint does not state a claim upon which relief can be granted.

SECOND DEFENSE

2. Answering Paragraph I of the complaint, defendant admits that the Pommerelle Company, Inc., was a corporation organized under the laws of the State of Washington, that its principal place of business was within the jurisdiction of this Court, but defendant has no knowledge or information sufficient to form a belief of the truth of every other allegation therein and therefore denies every other allegation therein.

3. The defendant admits the allegations of Paragraph II of the complaint.

4. Answering Paragraph III of the complaint, defendant admits that the Pommerelle Company, Inc., filed an income tax return for the period January 1, 1937, to October 4, 1937, indicating therein its income, excess profits and undistributed profits surtax [7] liability for that period, but defendant has no knowledge or information sufficient to form a belief of the truth of every other allegation in said paragraph and therefore denies every other allegation therein.

5. Answering Paragraphs IV and V of the complaint, defendant has no knowledge or information sufficient to form a belief of the truth of the allegations therein and therefore denies every allegation therein.

6. Answering Paragraph VI of the complaint, defendant admits that in the aforesaid income tax return filed by the Pommerelle Company it claimed a dividends paid credit which was disallowed, but defendant has no knowledge or information sufficient to form a belief of the truth of every other allegation therein and therefore denies every other allegation therein.

7. Answering Paragraph VII of the complaint, defendant admits that the claimed deduction stated therein was disallowed, but has no knowledge or information sufficient to form a belief of the truth of every other allegation therein and therefore denies every other allegation therein.

8. Defendant admits the allegations of Paragraph VIII of the complaint.

Wherefore, the defendant respectfully requests that judgment be entered for him dismissing the complaint, and for his costs and disbursements herein.

J. CHARLES DENNIS,
United States Attorney.

[Endorsed]: Filed Jan. 18, 1941. [8]

[Title of District Court and Cause.]

OPINION OF THE COURT

Jones, & Bronson, Colman Building, Seattle, Wash.,
Attorneys for Plaintiff.

J. Chas. Dennis, United States Attorney, Seattle, Wash.

Harry Sager, Assistant United States Attorney, Seattle, Wash.

Thomas R. Winter, Special Assistant to the Chief Counsel, Seattle, Wash.
Attorneys for Defendant.

Schwellenbach, District Judge.

In September, 1937, the directors of Pommerelle Company, Inc., (hereafter called the Old Company) concluded that the stated value of its capital stock was too low and that the corporation was paying excess profits taxes in an amount larger than the company's situation required. For the sole purpose of attempting to correct this situation and on the advice of the corporation's tax counsel, the following plan was devised and effectuated: (1) Proceedings were instituted for the liquidation of the old company. (2) All of the assets of the old company were transferred to plaintiff's as trustees for the stockholders and as liquidating trustees of the company by the declaration of a liquidating dividend. (3) The stockholders of the old company were [9] advised by the company that the receipt on their behalf by the trustees of their proportionate share

in the assets of the old company constituted a dividend subject to tax and every stockholder was advised as to the increase in his income tax resulting from the receipt of such dividend. (4) With one exception, each of the stockholders paid such income tax in accordance with such advice. (The exception was an isolated one and his failure to pay had no connection with the corporation or the plan). (5) Contemporaneous with these transactions, the Pommerelle Company (hereafter called the New Company) was formed. (6) Each stockholder of the Old Company was notified that he was free to choose as to whether or not to enter into the New Company and financial arrangements were made to make possible the purchase for cash from each stockholder of his proportionate share of the assets held for him by the plaintiffs as trustees. (7) Each stockholder subscribed for the stock of the New Company, the stock subscription obligation being payable in cash. (8) The subscribers to the capital stock of the New Company thereupon offered to the New Company that they would cause to be transferred to the New Company all of the assets held for them by the trustees subject to the obligations of the Old Company which the New Company was to agree to pay in fulfillment of their capital stock subscriptions of the New Company. (9) The New Company accepted the offer and stock was issued to the individuals in the same proportionate share as they owned stock in the Old Company. (10) The assets were shown on the books of the New Company as of their net value as shown

on the books of the Old Company. (11) The dissolution of the Old Company was completed.

In making income tax return for the year 1937, plaintiffs, as liquidating trustees, claimed a dividends paid [10] credit under Section 27 (f) of the Revenue Act of 1936, 49 Stat. 1648, on such portion of the amount distributed in liquidation which was properly chargeable to the earnings or profits of the Company accumulated after February 28, 1913. Defendant disallowed this credit. He contended that the foregoing transaction was not a liquidation as contemplated in Section 27 (f) of the Revenue Act of 1936, but was rather a reorganization as defined in Section 112 (g) (1) of the Revenue Act of 1936. He concluded that, since the transaction was a reorganization, it was not subject to a tax because there was no gain or loss which would be recognized under Section 112 of the Revenue Act of 1936. Defendant then concluded that, since there was no gain or loss recognized, the transaction was governed by Section 27 (h) of the Revenue Act of 1936 which provides "if any part of the distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part." In support of that position, defendant relies on Centennial Oil Co. v. Thomas (CCA 5, 1940) 109 Fed. (2) 359. Defendant contends that the taxes paid by the stockholders of the

Old Company on the liquidating dividends received by them were improperly paid and that, since the real distribution was to the New Company and the New Company was not subject to a tax as the result of the property it received and since subsection (h) of Section 27 of the Revenue Act of 1936 controls subsection (f) of the same section, that the dividends paid credit is not allowable. The undistributed profits tax was levied and paid. This action is for its return.

It should be noted at the outset that the purpose of the levy is to collect taxes imposed by Section 14 (b) of the [11] Revenue Act of 1936 upon the undistributed profits of a corporation. Under that section, the taxes are computed on such portions of the "undistributed net income" as are in excess of certain percentages of the "adjusted net income". The latter phrase is defined as net income less normal income tax and certain specified credits. The phrase "undistributed net income" is defined as "the adjusted net income minus the sum of the dividends paid credit provided in Section 27". It should further be noted that the sole purpose of the entire transaction was to secure an adjustment in the amount of the stated capital used in the business. Defendant does not challenge the propriety of attempting to accomplish this purpose. The testimony also is conclusive that if there was any avoidance of the undistributed profits tax, such avoidance was incidental and in no way may be considered as a motivating factor in the transaction.

There are two questions implicit in the decision of any tax case:

First, whether the mechanism adopted in a particular transaction had as its purpose the evasion of tax liability. I can find nothing ulterior in this transaction. Insofar as the undistributed profits tax is concerned, is isn't necessary here for the tax payers even to rely upon their recognized legal right (United States v. Isham, 17 Wall. 496; Superior Oil Company v. Mississippi, 280 U. S. 390; Jones v. Helvering, 71 Fed. (2d) 214) to decrease the amount of what otherwise would be their taxes by means which the law permits.

Second, the court must attempt to ascertain whether by the transaction the revenue raising ambition of the Congress in imposing the tax has been fulfilled. There can be no doubt from the legislative record that the purpose of Congress in imposing the undistributed profits tax was to increase [12] the revenue either by taxing corporations that failed to distribute their profits to their stockholders or by subjecting the stockholders to higher taxes as the result of forcing the corporate profits into the hands of the stockholders. (See statement of Senator King in charge of the Bill in the Senate, 80 Congressional Record, p. 8647, et seq.; statement of Senators Black and LaFollette in support of the so-called Black-LaFollette substitute, 80 Congressional Record, p. 8526 et seq.; statement of Congressman Doughton, Chairman, Ways and Means Committee, 80 Congressional Record, p. 10269 et

seq.) In the absence of clear and unambiguous language the Court will not deviate from the principle which is necessitated by the declared objective of Congress. Maguire v. Commissioner, 313 U. S. 1.

It is true that the argument was made to Congress, largely from outside the Congress, that other collateral benefits of an economic and social nature would accrue from the adoption of the measure; these to come from the increased purchasing power of the dividend-receiving stockholders. While this argument may have had its influence in the adoption of the measure, it was not the Congressional objective. The Congressional intent was limited to the possibility of the 710 million dollar revenue increase discussed by Chairman Doughton. Furthermore, Congress at all times fully recognized that the compelling of the expenditure of dividend moneys received by stockholders in the purchase of consumer goods did not lie within the sphere of legislative enactment. It must, therefore, be realized that the transaction under inspection here fully complied with the legislative purpose for the raising of revenue and that the mechanism used in the transaction was not devised with an ulterior purpose. [13]

Defendant relies upon a large number of cases holding that the courts will strictly scrutinize any corporate transaction which results in the avoiding of the payment of taxes; this for the purpose of seeing whether what results is tax avoidance or tax evasion. Too many cases are cited to justify an analysis of all of them here. They are all cases in

which the taxpayers attempt to evade the payment of taxes or gains resulting from the transfer or sale of corporate assets or securities. They are cases which would be in point here if this action was on behalf of the stockholders for the return of their individual taxes paid on the liquidating dividend from the Old Company and who sought such return on the ground that this was a non-taxable reorganization as defined in Section 112 (g) (1) of the Revenue Act of 1936, or as provided in any of the other subsections of Section 112. For example, in Minnesota Tea Co. v. Helvering, 302 U. S. 609, the money received by the corporation was turned over to its stockholders who agreed to pay off the indebtedness of the corporation in an amount equal to the amount which they received. The court held that this was not a distribution to the stockholders under the meaning of Section 112 (d) (1 and 2) of the Revenue Act of 1928, but was a taxable gain received by the corporation. The Supreme Court said:

> "Payment of indebtedness, and not distribution of dividends, was, from the beginning, the aim of the understanding with the stockholders and was the end accomplished by carrying that understanding into effect. A given result at the end of a straight path is not made a different result because reached by following a devious path. * * * The relation of the stockholders to the matter was that of a mere conduit."

In Gregor v. Helvering, 293 U. S. 465, the taxpayer was the owner of all of the stock of the original corporation. That corporation held a certain asset which she decided to sell for her individual benefit. For the sole purpose of [14] enabling her to sell this asset and make the profit without paying tax upon the gain, the taxpayer organized a new corporation to which the transfer was made. The Supreme court said:

> "But that corporation was nothing more than a contrivance to the end last described. It was brought into existence for no other purpose; it performed, as it was intended from the beginning it should perform, no other function. * * * The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization and nothing else."

These two Supreme Court cases are typical of cases upon which defendant relies in dealing with the question of the use of an artificial corporate reorganization for the purpose of avoiding the tax upon the gain realized as a result of the transfer or sale of a capital asset or security. Since the stockholders here are not seeking to avoid payment of the tax upon the gain received by them in the transaction, this group of cases is not in point here.

Typical of the second group of cases in which an effort was made to classify as a reorganization a

mere sale of capital assets by one corporation to another is Cortland Specialty Co. v. Commissioner, 60 Fed. (2d) 937). There the consideration was cash paid, promissory notes delivered and a promise to pay additional cash 9 days after the transaction was consummated. The basis for arguing that there was a reorganization was that the second corporation purchased 91½% of the assets of the first. The Circuit Court of Appeals for the Second Circuit said this:

> "Section 203 of the Revenue Act of 1926 must be interpreted in this setting. Its purpose was to relieve those interested in corporations of profits taxes in cases where there was only a change in the corporate form in which business was conducted without an actual realization of any gain from an exchange of properties. * * * There can be no justice or propriety in taxing one corporation who transfers its properties for cash and in relieving another that takes part of its pay in short time notes." [15]

The third group of cases upon which defendant relies are those referring to the relationship between the liquidating trustees and the corporation. Typical of these is Taylor Oil & Gas Co. v. Commissioner, 47 Fed. (2) 108. In this case, after a sale of all of the assets of the corporation has been negotiated, it was discovered that such a sale would result in such a profit as would cause a thirty thou-

sand dollar income tax liability to the company. With the sole purpose of avoiding this liability, it was decided to dissolve the company. Liquidating trustees were appointed for the purpose of dissolving the company and winding up its affairs. The court held the case was controlled by the Treasury regulation (Art. 547, Treas. Reg. 45, 1920) which provided:

> "The corporate existence is continued for the purpose of liquidating the assets and paying the debts and such receiver or trustees stand in the stead of the corporation for such purposes. Any sales of property by them shall be treated as if made by the corporation for the purpose of ascertaining a gain or loss."

These cases do not go far as to hold that the trustees may not also be trustees for the individuals who formerly were stockholders if there is a bona fide liquidation with no purpose of evading taxes.

In this case, in order to appraise the validity of defendant's initial position we must determine whether the transaction here involved comes within the definition of reorganization contained in Section 112 (g) (1) of the Revenue Act of 1936. This definition follows:

> (1) the term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of

> at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stock- [16] holders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

It requires no discussion to conclude that what we have here is not encompassed by subdivisions (A), (D) or (E). Subdivision (C) is eliminated by the case of Bondholders Committee, Marlborough Investment Company v. Commissioner, #128 and #129, October Term, 1941, 314 U. S. .., in which the Supreme Court said:

> "Clause B covers certain transfers 'by a corporation' of all or a part of its assets 'to another corporation' where the transferor or its stockholders continued in control. These were not 'properties' of Marlborough Investment Co. It had long since ceased to own them. It was not the 'transferor'. * * * The 'reorganiaztion' provisions in question cover only inter-corporate transactions".

Plaintiffs contend that this transaction does not

come within the purview of subsection B for the reason that the acquisition by the New Company was not an exchange solely of all or a part of its voting stock but that there was included the actual consideration of the assumption of the liabilities of the Old Company by the New Company. But, as was pointed out in Helvering v. Southwest Consolidated Corporation, #286, October Term, 1941, 314 U. S. .., Congress, in 1939, amended Clause B by adding: "But in determining whether the exchange is solely for voting stock, the assumption by the acquiring corporation of a l*ib*ility of the other, or the fact that property acquired is subject to a l*ib*ility, shall be disregarded." 53 Stat. 871. This amendment was made retroactive as far back as 1924. It was adopted to avoid the consequences of United States v. Mendler, 303 U. S. 564.

Plaintiff further contends that this transaction is not covered by B because there is lacking in it the continuity of interest made requisite in the case of Pinellus Ice & Cold Storage Co. v. Commissioner of Internal Revenue, 287 U. S. [17] 462. Whether this contention is correct depends upon the meaning of the Supreme Court in the case of Helvering v. Alabama Asphaltic Limestone Company, #328, October Term, 1941, 314 U. S. ... In that case, the Court, speaking through Justice Douglas, stated:

> "From the Pinellas case, (287 U. S. 462) to the Le Tulle Case (308 U. S. 415) it has been recognized that a transaction may not qualify as a "reorganization" under the various rev-

> enue acts though the literal language of the statute is satisfied. * * * The Pinellas case introduced the continuity of interest theory to eliminate those transactions which had 'no real semblance to a merger or a consolidation' (287 U. S. p. 470) and to avoid a construction which 'would make evasion of taxation very easy.' "

The sole question decided in the Alabama Limestone case is that the continuity requirements of the Pinellas and the Le Tulle cases are satisfied where the creditors of an insolvent debtor step into the shoes of the stockholders by virtue of invoking the processes of law prior to the actual transfer to the new corporation. It dates the equity ownership of the creditors from the time of the institution of bankruptcy proceedings. The Court took care to emphasize that this conclusion involved no conflict with the principle of the Le Tulle case. It made clear that the "determinative and controlling factors" were the "debtors' insolvency and an effective command by the creditors over the property."[5]

The answer to this particular problem in this case must be found in an analysis of the last paragraph of the Alabama Limestone decision. Here the new company did not receive its assets directly from the old company but from plaintiffs as trustees. Was this break in the chain a mere "transitory phase of an arrangement" which added "nothing of substance to the complete affair"? Was it "no more than" an "intermediate procedural

device utilized to enable the new corporation to acquire all the assets of the old one"? [18] In answering these questions, it is important to note that in using this language, the Supreme Court cites Gregory v. Helvering, 293 U. S. 465, and Helvering v. Bashford, 302 U. S. 454. In the Gregory case, it will be remembered the Court denominated the conveyance as "an elaborate and devious form * * * masquerading as a corporate reorganization." In the Bashford case, a temporary ownership of the stock by the intermediary was declared to be not only transitory but also "without real substance".

In the case at bar, the holding of the assets of the Old Company by palintiffs was of brief duration. During that duration, however brief, the persons who were stockholders of the Old Company had an absolute irrevocable right to insist upon receiving their proportionate share of the assets of the Old Company. It is true that no one of them exercised that right. The fact that no one of them exercised the right raises the question of good faith in determining whether their right was something "of substance added to the complete affair". The question of good faith must be resolved in favor of the transaction on the basis of the fact of the payment of income tax by all but one of the old stockholders. This was a positive recognition by each of them that during the interim period they owned their respective interests in the assets formerly owned by the Old Company, not as stockholders in either company but as individuals. That being true, plain-

tiffs transferred the assets not as liquidating trustees of the Old Company but as trustees for the individuals who had been stockholders of the Old Company. Consequently, the continuity requirement is not satisfied and this cannot be classified as a reorganization as defined in the statute.

In his reply brief, largely as a result of suggestions by the Court during oral argument, defendant suggests that the Court should disregard the details of the transaction [19] and consider substance rather than form. He urges that the New Company had the same assets, the same stockholders and the same business as the Old Company and that those assets in excess of paid in capital were not distributed but were still in use by the New Company. He urges that, consequently, the undistributed profits tax should be levied. Such an argument is tempting and attractive. Its attraction comes from its simplicity. Its danger lies in its over-simplification. Discussing a similar argument in the case of Commissioner v. Sansome, 60 Fed. (2) 931, Judge Learned Hand said that the courts had beclouded troublesome questions "by recourse to such vague alternatives as 'form' and 'substance', anodynes for the pains of reasoning." I wish to make it clear that defendant's counsel offered the argument only because the court, during oral argument, suggested it and not as a substitute for his very carefully reasoned and well-documented brief.

Even if defendant's position was correct and we were compelled to ignore the distribution to the in-

dividual stockholders of the Old Company and the taxes paid by them thereon, defendant would be confronted with the provisions of subdivision (f) of Section 27 of the Revenue Act of 1936, 49 Stat. 1648, which reads as follows:

> "(f). Distribution in Liquidation—In the case of amounts distributed in liquidation, the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid."

Defendants meets this subsection with the argument that it is qualified by subsection (h) of Section 27 of the Revenue Act of 1936 which I have previously quoted. He contends that, since a part of the distribution made in this case is not a taxable dividend in the hands of the New Company for [20] the period in which the distribution was made, no dividend paid credit should be allowed with respect to such part. To reach such a conclusion, it is necessary to find that subsection (h) qualifies or controls subsection (f). This question has been decided adversely to defendant's position in numerous cases by the Board of Tax Appeals. A most complete discussion of the subject is found in the case of Credit Alliance Corporation v. Commissioner, 42 B. T. A. 1020. The question has been considered by three of the Circuit Courts of Appeal. In the

first case, Centennial Oil Co. v. Thomas, 109 Fed. (2) 359, the Firth Circuit sustained defendant's position but with a most vigorous dissenting opinion by Judge Hutcheson. On the petition to review the decision of the Board of Tax Appeals in the Credit Alliance case, the Circuit Court of Appeals for the Fourth Circuit decided unanimously against defendant's position. Helvering v. Credit Alliance Corporation, 122 Fed. (2) 361. The Circuit Court of Appeals for the Second Circuit held likewise in Commissioner v. Kay Mfg. Corporation, 122 Fed. (2) 442. It is my duty to accept the weight of authority upon this question. Furthermore, the Supreme Court has granted certiorari in the Credit Alliance case and what I may say upon the merits need only be brief. However, in each of the three cases which reached the Circuit Courts there was involved an issue which is not present here. That was the question of the simplification of corporate structure and the relationship between the Message of the President on June 19, 1935 (H. R. Rep. #1681, 74th Cong. 1st Session, p. 4) and the language of the 1936 Act. Because of that, I will state briefly why I think the defendant's position is unsound.

Fundamentally, the difference of opinion involves a conflict between two rules of statutory interpretation. In the various cases, the Commissioner maintained that subsection [21] (h) should be controlling because it came later in the statute than subsection (f). This rule runs head on into another rule to the affect that as between two sections of

the statute that which is the more specific will take precedence over that which is the more general. It is my opinion that the second rule is much more persuasive than the first. There is no sound legislative practice to support the first. A complicated bill cannot be written in one paragraph or one section. There is no reasonable relationship between the position of a section in the statute and its importance. It is an arbitrary rule of construction which has been called artificial and to be resorted to only in extremis. 59 C. J. 1000; People ex rel Mason v. McLane, 90 N. Y. 83; Commercial Trust Co. v. Hudson County, Board of Taxation, 86 N. J. L. 424; 92 Atlantic 263.

On the other hand, there is a sound reason for the second rule. When the legislature deals with a specific subject, the courts have a right to assume that much more particular and specific care was given then when it deals with a general subject. United States v. Chase, 135 U. S. 255; Rodgers v. United States, 185 U. S. 83. There can be no doubt that subsection (f) is more specific than subsection (h). It limits its effect to distribution in liquidation and it involves not the entire distribution in liquidation but only a specific part of it. Subsection (h), on the other hand, concerns itself with distributions in general.

To hold that subsection (h) controls subsection (f) would be to hold that subsection (f) merely provides that the distribution be considered a dividend and ignores the words "taxable" and "paid".

Under the rulings of the courts, a distribution in liquidation is not considered a dividend. Hellmich v. Hellman, 276 U. S. 233. But by the language of subsection (f), Congress included in the category of divi- [22] dends for the purposes of the Section that which was not previously considered a dividend. Congress further provided that distributions which they included in the category of dividends should be treated "as taxable" and "paid". On this point, it is of interest to note that the inclusion of the word "paid" came as a result of action by the Senate in the form of a committee amendment adopted on the motion of the Committee on Finance of that body. 80 Congressional Record p. 8792. This strengthens the conclusion that it was purposefully inserted.

To me it seems that the most logical interpretation of the relationship between the two subsections is found in the language of the Board of Tax Appeals in the opinion in the Credit Alliance Corporation case when it said:

> "In our opinion Congress, by subsection (h) intended to cover dividend distributions and to say that, if taxable, they confer dividends paid credit; and, separately, intended by subsection (f) to cover a different category, towit, distributions in liquidation, and to say that, although not within the category of 'dividends' they shall be treated so as to confer dividends paid credit to the limited degree provided in subsection (f)".

Certainly the Congress intended that subsection (f) should have some meaning which would not be completely nulified and negatived by subsection (h). To my mind, this is the only logical interpretation that can give due weight to the congressional intent indicated by the inclusion of both of the subsections.

In addition to the disallowance of the dividends paid credit, defendants disallowed and collected taxes on an item of $675 for accounting and legal services. This disallowance was on the theory that all of the services rendered were for the reorganization and should properly have been set up in the capital account as organization expense of the New Company. Having held against the defendant upon the question of reorganization and since the services were rendered to the [23] Old Company which went out of existence during the taxable year, these items were properly chargeable to expense and properly deductible as such. In addition to that, the undisputed testimony shows that, of the $675, $450 were for ordinary, regular accounting and legal services which had nothing to do with the transaction involved in this case. Under any theory of the case, plaintiffs were entitled to deduct $450 as a part of the Old Company's ordinary operating expenses.

Findings of fact and judgment may be prepared in accordance with this opinion.

February 14, 1942.

L. B. SCHWELLENBACH
United States District Judge.

[Endorsed]: Filed Feb. 16, 1942. [24]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled cause came on regularly for trial on the 13th day of January, 1942, before the above-entitled Court, Honorable Lewis B. Schwellenbach presiding therein, sitting without a jury.

Plaintiffs appeared by their attorneys, Jones & Bronson, and were represented in Court by Mr. H. B. Jones and Mr. R. B. Hooper, and the defendant appeared by its attorneys, Mr. J. Charles Dennis and Mr. Frank Hale, United States Attorneys, and was represented in Court by Mr. Thomas S. Winter, Deputy United States Attorney.

Witnesses were sworn and testimony given at the said hearing, and the Court being fully advised in the facts and the law, makes its

FINDINGS OF FACT

I.

That the Pommerelle Company, Inc., at all times hereinafter mentioned prior to the 8th day of April, 1938, was a corporation organized, existing and doing business under and by virtue of the laws of the State of Washington; that it was legally dissolved under the laws of the State of Washington on the 8th day of April, 1938; that the plaintiffs, W. Braicks and J. D. Molz were and are the duly elected and qualified liquidating trustees of said corporation, this cause of action thereby vesting in them under

the laws of [25] *under the laws of* the State of Washington. The corporation's principal place of business and the residence of each plaintiff is within the judicial district of the above-entitled court. Each plaintiff and the said corporation is and was a citizen of the United States, and each has at all times borne true allegiance to the government of the United States and neither has in any way voluntarily aided, abetted or given encouragement to rebellion against the United States. No assignment or transfer of this claim, or any part thereof, or any interest therein has been made.

II.

The defendant at all times hereinafter mentioned was the Acting Collector of Internal Revenue of the United States for the Collection District of Washington, having an office and residing at Tacoma, Pierce County, within the above-entitled district, and the said defendant now is a citizen of the State of Washington, Pierce County therein.

III.

During 1937 and before September 30, 1937, the said corporation incurred expenses totaling $675.00 in connection with professional legal and accounting services rendered to it. Of this amount, the sum of $75.00 was incurred for legal expenses in connection with an increase in the corporation's capital stock; the sum of $450.00 was paid for ordinary accounting services in connection with the auditing of the books of the corporation; and the sum of $150.00 represented accounting expenses in connection with the

liquidation of the corporation. The sum of $675.00 charged for the said services was reasonable and was paid by the corporation, and the corporation reported as a deduction from income in its tax return for the year 1937, the said expenses as reasonably and necessarily incurred in the business of the corporation. This deduction was disallowed by the Internal Revenue Agent [26] which disallowance resulted in an additional assessment of excess profits tax in the amount of $82.00.

IV.

In September, 1937, the directors of Pommerelle Company, Inc., concluded that the stated value of the company's capital stock was too low and that the corporation was paying excess profits taxes in an amount larger than the company's situation required. For the sole purpose of attempting to correct this situation and on the advice of the corporation's tax counsel, proceedings were instituted for the liquidation of the corporation and a resolution was passed duly appointing the plaintiffs herein as trustees to wind up and liquidate the assets and affairs of the said company and to conduct a voluntary liquidation and dissolution out of Court in accordance with the laws of the State of Washington.

V.

Pursuant to the resolution, all of the assets of the corporation were transferred to and vested in the plaintiffs as trustees for the stockholders and as liquidating trustees of the company. The stockholders were advised by the company that the receipt

on their behalf by the trustees of their proportionate shares in the assets of the corporation constituted dividends subject to tax and every stockholder was advised as to the increase in his income resulting from the receipt of such dividend. With one immaterial exception, each of the stockholders paid an income tax thereon in accordance with this advice.

VI.

Contemporaneously with these transactions, a new company was formed under the laws of the State of Washington, called the Pommerelle Company. Each stockholder of the old company was notified that he was free to retain or dispose of his interest in the assets of the old company and to [27] choose whether or not he would enter into the new company. Financial arrangements were made to purchase for cash from any stockholder who did not desire to go into the new company, his proportionate share of the assets held for him by the plaintiffs as trustees. Each stockholder subscribed for the stock of the new company, which subscription obligation was payable in cash. The subscribers to the capital stock of the new company thereupon made an offer to the new company to transfer all of the assets held for them by the trustees, subject to the obligations of the old company, which obligations the new company was to agree to pay, in fulfillment of their capital stock subscriptions to the new company. The new company accepted the offer, the trustees then transferred to it all the assets held by them for the individual stockholders, and stock was issued to the indi-

viduals in the same proportionate share as their interest in the assets of the old company. The assets thereupon appeared on the books of the new company at the net value at which they were shown on the books of the old company.

VII.

In the income tax return of the old company for 1937 plaintiffs as liquidating trustees, claimed a dividends paid credit under Section 27 (f) of the Revenue Act of 1936, 49 Stat. 1648, equal to that portion of the amount distributed in liquidation which was properly chargeable to the earnings or profits of the company accumulated after February 28, 1913. The Internal Revenue Agent disallowed this credit, which disallowance resulted in a deficiency assessment in the amount of $7,187.26 as surtax on an undistributed profits under Section 14 of the Revenue Act of 1936. [27a]

VIII.

On or about January 16, 1940, the defendant, acting under the instruction of the Commisisoner of Internal Revenue, notified the corporation that it was liable for a further assessment under the provisions of Section 14 of the Revenue Act of 1936, in the sum of $7,346.34 in income taxes and $144.62 in excess profits tax, making a total deficiency assessment of $7,490.96. Thereafter, acting under the authority of the Commissioner of Internal Revenue, the defendant required the plaintiffs, as liquidating trustees, to and thereupon they did pay to the de-

fendant the sum of $7,490.96 in payment of the said deficiency assessment and $918.89 as interest thereon from March 15, 1938. On or about April 9, 1940, plaintiffs filed with the defendant for transmission to the Commissioner of Internal Revenue a claim for refund and repayment of the said amount. This claim was made and duly filed upon the official form prescribed therefor by the Treasury Department of the United States and was filed within three years after the date of payment of said taxes, and said claim set forth the reasons for and the ground supporting the refund of said taxes. No allowance or disallowance of such claim has been made by the Commissioner of Internal Revenue.

Dated this 21st day of Feb. 1942.

LEWIS B. SCHWELLENBACH
United States District Judge

Presented by:

R. B. HOOPER
Of attorneys for plaintiffs

From the foregoing Findings of Fact, the Court makes and enters the following [28]

CONCLUSIONS OF LAW

I.

The plaintiffs have complied with all statutory conditions constituting conditions precedent to the institution and maintenance of this suit.

II.

The transaction entered into in September, 1937,

by means of which the old Pommerelle Company, Inc., was liquidated and a new company formed was a liquidation within the contemplation of Section 27 (f) of the Revenue Act of 1936 and did not come within the definition of a reorganization as set forth in Section 112 (c) (1) of the Revenue Act of 1936. Under the resolution of liquidation herein the stockholders of the old company, immediately after the declaration of a liquidating dividend, owned their respective interests in the assets formerly owned by the old company, not as stockholders in either company, but as individuals. Thereafter, the transfer by plaintiffs of these assets was made by them as trustees for the individuals who had been stockholders of the old company and not as liquidating trustees of the old company. The continuity requisite for the establishment of a reorganization hence did not exist.

III.

The plaintiffs were entitled to a dividends paid credit in reporting the income of the old company for the year 1937, to the extent of that amount distributed in the liquidation transaction which was properly chargeable to the earnings or profits accumulated after February 28, 1913, under the provisions of subdivision (f) of Section 27 of the Revenue Act of 1936. In holding and determining that the said dividends paid credit was not allowable and that additional tax was therefore due under Section 14 of the Revenue Act of 1936, [29] the Commissioner of Internal Revenue has exceeded the author-

ity granted him under the Internal Revenue Act of 1936.

IV.

The expenses incurred by the taxpayer corporation in 1937 for professional services rendered to it in connection with the increase of its capital stock, the audit of its books for 1937, and the accounting for its liquidation, were properly deductible in full in the taxable year of 1937 as an ordinary and necessary expense incurred in the business of the corporation.

V.

Under the evidence and the law, the plaintiffs are entitled to judgment against the defendant in the sum of $8,338.98 together with interest thereon from the 9th day of April, 1940, at the rate of 6% per annum until paid together with plaintiffs' costs and disbursements as provided by law.

Dated this 21st day of February, 1942.

LEWIS B. SCHWELLENBACH,
United States District Judge.

Presented by:

R. B. HOOPER
Of Attorneys for Plaintiffs.

[Endorsed]: Filed Feb. 21, 1942. [30]

In the District Court of the United States for the Western District of Washington, Southern Division.

No. 189

W. BRAICKS and J. G. MOLZ, liquidating trustees of POMMERELLE COMPANY, INC., a corporation,

Plaintiffs,

vs.

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Defendant.

JUDGMENT

The above-entitled cause came on regularly for trial on the 13th day of January, 1942, before the above-entitled Court, Honorable Lewis B. Schwellenbach presiding therein, sitting without a jury.

Plaintiffs appeared by their attorneys, Jones & Bronson, and were represented in Court by Mr. H. B. Jones and Mr. R. B. Hooper, and the defendant appeared by its attorneys, Mr. J. Charles Dennis and Mr. Frank Hale, United States Attorneys, and was represented in Court by Mr. Thomas S. Winter, Special Assistant to the Chief Counsel, Bureau of Internal Revenue.

Witnesses were sworn and testimony given at the said hearing, and the Court being fully advised in the facts and the law, and having made and entered its Findings of Fact and Conclusions of Law herein.

Now, Therefore, it is Ordered, Adjudged and Decreed that plaintiffs have and recover judgment against the defendant in the sum of $8,338.98, together with plaintiffs' costs and disbursements to be taxed as provided by law, and for the payment of interest provided by law.

Dated this 21st day of Feb., 1942.

LEWIS B. SCHWELLENBACH,
United States District Judge.

Presented by:

R. B. HOOPER,
Of Attorneys for Plaintiffs.

Judgment corrected and amended pursuant to Stip. and Order filed May 8, 1942.

E. REDWAYNE,
Dep. Clerk. [31]

I, Lewis B. Schwellenbach, District Judge of the United States, and sitting in the District Court of the United States for the Western District of Washington, on this 21st day of February, 1942, do hereby certify:

That the acts done by the defendant in the above entitled case, as the Collector of Internal Revenue, in imposing and assessing and exacting and collecting the said excise tax, in the amount of $8,338.98, as set forth in the foregoing judgment, were done in his official capacity as such Collector of Internal Revenue, and the said Thor W. Henricksen had probable cause for his acts, notwithstanding the fact that all of said tax was erroneously

collected, and judgment has been rendered for a refund thereof in this case.

Dated this 4th day of March, 1942.

LEWIS B. SCHWELLENBACH,
United States District Judge.

[Endorsed]: Filed Mar. 4, 1942. [32]

[Title of District Court and Cause.]

STIPULATION AND ORDER CORRECTING JUDGMENT

It is hereby stipulated and agreed by and between the plaintiffs, by their attorneys, Jones & Bronson, and defendant, by his attorneys, J. Charles Dennis, United States Attorney for the District of Washington and Thomas R. Winter, Special Assistant to the Chief Counsel for the Bureau of Internal Revenue, that judgment in the above case dated the 21st day of February, 1942, be corrected by striking from said judgment, beginning at Line 25, the words—

> "together with interest thereon from the 9th day of April, 1940, to date at the rate of six per cent (6%), in the amount of $933.97, making a total judgment of $9,272.95, together with plaintiff's costs and disbursements to be taxed as provided by law, said judgment to bear interest at six per cent (6%) from this date until paid"

and inserting in lieu thereof the words——

> "together with plaintiffs' costs and disbursements to be taxed as provided by law and for the payment of interest as provided by law".

Dated this 28th day of April, 1942.

JONES & BRONSON,
R. B. HOOPER,
Attorneys for Plaintiffs.
J. CHAS. DENNIS,
THOMAS R. WINTER,
Attorneys for Defendant. [33]

Upon the above stipulation of the parties by their attorneys and good cause appearing therefor, it is hereby Ordered that the judgment be so amended.

Dated this 30 day of April, 1942.

L. B. SCHWELLENBACH,
Judge.

Presented by:

THOMAS R. WINTER.

[Endorsed]: Filed May 8, 1942. [34]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Thor W. Henricksen, Acting Collector of Internal Revenue, defendant above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the

final judgment dated the 21st day of February, 1942, and filed in the above-entitled Court on the 4th day of March, 1942, which judgment was corrected by an order dated the 28th day of April, 1942, and filed May 8, 1942.

Dated this 1st day of June, 1942.

J. CHARLES DENNIS,
United States Attorney.

THOMAS R. WINTER,
Special Assistant to the Chief Counsel, Bureau of Internal Revenue.

Copy mailed to Jones & Bronson, attys. for Pltfs., Colman Bldg., Seattle, June 1, 1942.

E. REDWAYNE,
Dep. Clerk.

[Endorsed]: Filed Jun. 1, 1942. [35]

[Title of District Court and Cause.]

ORDER EXTENDING TIME

It is hereby stipulated by and between the defendant appellant, by his attorneys, J. Charles Dennis, United States Attorney for the District of Washington, and Thomas R. Winter, Special Assistant to the Chief Counsel for the Bureau of Internal Revenue, and plaintiffs appellees, by their attorneys, Jones & Bronson, that the time for filing the record on appeal and the docketing of the action shall be extended to a date ninety days from the date of

first notice of appeal, which date was June 1, 1942, and that an order may be entered granting such extension.

/s/ J. CHAS. DENNIS,
United States Attorney.

/s/ THOMAS R. WINTER,
Special Assistant to the Chief Counsel Bureau of Internal Revenue. Attorneys for Defendant Appellant.

/s/ JONES & BRONSON,
(H. B. JONES),
Attorneys for Plaintiffs Appellees.

Approved and so ordered this 6th day of July, 1942.

/s/ LLOYD L. BLACK,
United States District Judge.

[Endorsed]: Filed Jul. 7, 1942. [36]

[Title of District Court and Cause.]

STATEMENT OF FACTS

Be It Remembered, the above-entitled action came on regularly for hearing on this, the 13th day of January, 1942, before the Honorable L. B. Schwellenbach, United States District Judge, sitting in Tacoma, Washington;

The plaintiffs herein appeared in person and by

their Counsel, Jones & Bronson, Attorneys-at-Law, Colman Building, Seattle, Washington;

Thomas R. Winter Esq., Special Assistant to the Chief Counsel, Bureau of Internal Revenue, and Harry Sager, Esq., Assistant United States Attorney, appeared for and on behalf of the defendant herein;

Whereupon, the following proceedings were had and testimony taken, to-wit:—[39]

The Court: How about the case of Braicks v. United States of America?

Mr. Winter: The defendant is ready, if the plaintiff is, Your Honor.

Mr. Jones: Yes, the plaintiff is ready in that case.

I anticipated, like Counsel, that we probably wouldn't do more than get through this first case this morning, so I told the witnesses to come this afternoon, but when I saw how we were going, I telephoned and asked them to come right away; however, I am satisfied we can occupy most of the morning with the things we have and then I think we can get through, easily, this afternoon.

This is quite a technical case, as Your Honor may have noted from reading the Brief—that is, the main point in it.

The facts are, roughly, these:

(Makes opening statement for the plaintiffs herein.)

Mr. Winter: (Makes opening statement for the defendant herein.)

It was never intended in this case, Your Honor, to actually liquidate the corporation. If Your Honor has read the depositions, that is very well put by one of the witnesses, when he was asked:

"Q. Did you understand you were selling your stock or not?

"A. No, I wasn't selling it." [40]

"Q. You were trading stock in the new corporation?

"A. Yes.

"Q. That was your understanding?

"A. Yes."

Mr. Jones (Interrupting): The witness had the Notary correct that testimony you read. He said that he either misspoke himself or it was incorrectly reported.

Mr. Winter: That is what he testified to.

I, distinctly, remember it.

Mr. Jones: You notice he has corrections on that point?

Mr. Winter: The copy furnished me had no correction in it.

Mr. Jones (Indicating): This was furnished me this morning.

The Court: Do you want to read these depositions, now?

Mr. Jones: Yes. That might be the best thing to do at this time. I think, if it were agreeable, I think we should submit the depositions and have an opportunity to organize the case during the Noon hour.

I will ask to have the depositions published.

The Court: They may be published.

Counsel may read the depositions.

(Whereupon, the depositions just referred to were published, and read by Counsel herein.) [41]

[Title of District Court and Cause.]

DEPOSITIONS OF AUGUST BUSCHMANN, C. S. LEEDE, ED HULETZ and GILBERT M. KROLL.

Be It Remembered, that heretofore and on to-wit October 23, 1941, at the hour of 3:00 p. m. the depositions of August Buschmann, C. S. Leede, Ed Huletz and Gilbert M. Kroll, were taken on behalf of the plaintiffs at Room 610, Colman Building, Seattle, Washington, before J. W. Greb, Jr., Notary Public, pursuant to oral stipulation;

Plaintiffs appearing by H. B. Jones, Esq., (Messrs. Jones & Bronson), their attorney and counsel;

Defendant appearing by Thomas R. Winter, Esq., Special Attorney, Bureau of Internal Revenue; and [42] Harry Sager, Esq., Assistant U. S. District Attorney;

Whereupon the following proceedings were had:

Mr. Jones: May the record show that the depositions of August Buschmann, C. S. Leede, Ed Huletz and Gilbert M. Kroll, on behalf of the plain-

tiffs, may be taken pursuant to stipulation, for use upon the trial of this Cause?

Is that agreeable to you?

Mr. Winter: Yes, subject, however, to all legal objections.

Mr. Jones: That is right. I will call Mr. Buschmann to be sworn and testify, first.

AUGUST BUSCHMANN,

called as a witness on behalf of the plaintiffs, being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. Will you state your name?

A. August Buschmann.

Q. Mr. Buschmann, were you a stockholder in a company known as Pommerelle Company, Inc., in the year 1937? A. Yes, I was.

Q. I will show you what is entitled a call and waiver of notice of special meeting, which is contained in the Minute Book of the Pommerelle Company, which will be produced upon the trial of this Cause, and which gives notice of a call of a special meeting of the stockhold- [43] ers to be held at the office of the company on September 30, 1937, and call your attention to the signatures there, and ask you if that is your signature where it appears as August Buschmann?

A. Yes, that is my signature.

Q. Did you attend that meeting?

(Deposition of August Buschmann.)

A. Yes, I did.

Q. And, just generally speaking, will you tell us what, as you recall it, was the subject under consideration at that meeting?

Mr. Winter: I don't know if Your Honor wants us to make objections to questions, but certainly that question is leading.

The Court: Was there any stipulation as to objections?

Mr. Winter: We reserved the right——

The Court (Interrupting): Objections to the form of questions should be taken at the time of taking the deposition.

Mr. Jones: This was taken on notice, there wasn't any stipulation.

Mr. Winter (Continuing, from Line 16, above): ——the reporter hasn't put it down—at the time we started the depositions, I said "subject to all legal objections."

The Court: I will overrule the objection.

Those objections should have been taken specifically at the time of taking of the depositions.

Mr. Winter: That is the reason I made the statement, if the Court please, so we wouldn't interrupt [44] the witness in taking the deposition.

The Court: I will further overrule it, that isn't legal.

Q. And just generally speaking, will you tell us what, as you recall it, was the subject under consideration at that meeting?

(Deposition of August Buschmann.)

A. As I recall it, the subject under consideration was the liquidation of the old Pommerelle Company.

Q. And do you recall whether or not, in connection with the liquidation, there was any discussion as to the rights or the privilege of stockholders of the Company, about whether they could take their liquidated portion in cash or not?

A. There was.

Q. What, in general, was the substance of that discussion?

A. Well, as I recall it, Mr. Braicks, our president, said that if we wanted to sell our stock, why he would be prepared to buy anyone out that wanted to sell their stock.

Q. State whether or not you were subsequently advised by anyone as to the amount of profit you were to report in connection with the transaction?

A. Yes, I was advised.

Q. Did you receive any letters or documents in that connection? A. I did.

Q. Can you identify those papers?

A. Yes.

Q. What are they?

A. Well, one of them gives an itemized way of figuring [45] our income tax on the basis of the liquidation, and the other one is a letter accompanying the dividend.

Q. How did those come to you?

A. By mail.

(Deposition of August Buschmann.)

Q. And have been in your possession since that time? A. Yes.

Mr. Jones: I will offer those as Exhibit 1 to this witness's deposition.

Mr. Winter: We will reserve our objection to them.

Mr. Jones: I offer those as Exhibit 1. Those, I presume, are attached to the original deposition and should consist of a general statement, showing the computation of a general statement, showing the computation of taxes, etc. shareholders' profits, etc.

Mr. Winter: We object, if the Court please, on the ground it is self-serving, it is a self-serving document and has no bearing on this case and is contrary to the contention of the defendant that they were, in fact, dividends and that they are self-serving.

The Court: They got a check for some comparatively small amount?

Mr. Jones: I think only a few dollars of adjustments made in some cases, the amounts were just a few dollars, but outside of that, I believe no checks were issued.

The Court: I will overrule the objection.

A letter addressed to the witness, dated February 16, 1938, from The Pommerelle Company, being a detailed statement showing net profit for income tax report; and a letter addressed to the witness, dated February 15, 1938, from The Pommerelle Company, admitted in evidence as Plaintiffs' Exhibit No. 1 to the deposition.

(Deposition of August Buschmann.)

PLAINTIFFS' EXHIBIT No. 1
TO DEPOSITION

Phone ELiot 0843 Bonded Winery

THE POMMERELLE COMPANY, Inc.
716 Dearborn Street
Wines and Apple Juice

Seattle, Wash.
February 16, 1938

Mr. August Buschmann
Colman Building
Seattle, Washington

Dear Mr. Buschmann:

Enclosed you will find a detailed statement showing net profit for your Federal Income Tax report.

No. of Shares Purchases	Total	Date Purchased	Cost At Par
1,000		10-21-35	1,000.00
500		6-10-35	500.00
1,050	2,550	12-14-36	1,050.00

Distribution Oct.4, 1937	Total	Profit	Total
2,408.76		1,408.76	
1,204.38		704.38	
2,529.20	6,142.34	1,479.20	3,592.34

Time Held	Per Cent of Profit to Report	Net Profit To Report
1 to 2 Years	80	1,127.01
2 to 5 Years	60	422.63
Under 1 Year	100	1,479.20
Total		$3,028.84

(Deposition of August Buschmann.)

P. S. The check received represents a 5c per share dividend on your 6,143 shares of stock.

Yours very truly,
THE POMMERELLE COMPANY
By E. PFISTERER

Copy mailed to Mr. Cowan 2/17/38.

Phone ELiot 0843 Bonded Winery

THE POMMERELLE COMPANY, INC.
716 Dearborn Street
Wines and Apple Juice

Seattle, Wash.
February 15, 1938

Mr. August Buschmann
Colman Building
Seattle, Washington

Dear Mr. Buschmann:

Enclosed you will find your dividend check for the year 1937. It will be necessary for you to report a net profit of $3,028.84 on your Federal Income Tax statement.

Yours very truly,
T*EH* POMMERELLE COMPANY
By E. PFISTERER

[Endorsed]: Filed October 23, 1941.

(Deposition of August Buschmann.)

Q. (By Mr. Jones) State whether or not you filed an income tax return for the year 1937?

A. I did.

Q. And state whether or not you included in that return the profit that you were advised had accrued to you on the liquidation of the Pommerelle Company stock?

Mr. Winter: I object to that on the ground the return is the best evidence of what it included.

Mr. Jones: Counsel is right on that but the reason for this was we had asked for the production of the returns but were advised they could not be produced, except under compulsion or consent and this was laying the foundation to either get the returns, themselves, or, if they weren't available to prove by secondary evidence—and his answer was he did include this in his return. It is not a case of proving the details of the instrument by secondary evidence, just prove the substantive fact, if he did make a return which included this item—whether it is correct, is not so material.

The Court: I will overrule the objection on the basis you will connect it up?

Mr. Jones: Yes, we will.

Q. (Repeating) And state whether or not you included in that return the profit that you were advised had accrued to you on the liquidation of the Pommerelle Company stock? A. I did.

Q. Are you willing for your income tax return

(Deposition of August Buschmann.)

to be produced and submitted to the court in connection with the trial of this cause? A. Yes. [47]

Mr. Jones: Do you have his tax return here?

Mr. Winter: I have a photostatic copy of it.

Mr. Jones: Would you be willing to let Mr. Buschmann see it?

Mr. Winter: Yes.

Q. Mr. Buschmann, this photostatic copy of your tax return, which Mr. Winter has produced, and which I assume you will produce at the trial, will you, Mr. Winter?

Mr. Winter: If Mr. Buschmann will consent.

Q. (By Mr. Jones) Yes. Is that a copy of your return and of your signature?

A. I am sorry; I can't tell you whether it is a copy of my return or not, because I can't remember that far back.

Q. Will you look and see whether it purports to be signed by you?

A. Where would the signature be? On the back here?

Mr. Winter: Right here.

The Witness: Yes, that is my signature.

Q. (By Mr. Jones) That is your signature?

A. Yes, sir.

Q. And you are willing that this photostatic copy be produced and exhibited upon the trial of this cause, are you? A. Surely. Surely.

Q. Have you ever claimed any refund of the

(Deposition of August Buschmann.)

tax paid by you on this return on the profit received from the Pommerelle stock?

A. Not that I know of.

Mr. Jones: That is all. [48]

Cross Examination

By Mr. Winter:

Q. Were you a stockholder, Mr. Buschmann, in Pommerelle Company, Inc. from the time of its organization?

A. You mean the original company?

Q. Yes.

A. Not at the time of its original organization. I bought some stock in the company after it was organized. I don't recall how long it had been organized when I eventually bought.

Q. When did you buy your stock?

A. I think around 1934 or '35, or something like that. I can tell you when I get down to the office exactly, but I don't recall it exactly now.

Q. Did you buy all of your stock at one time, or various times?

A. I think I bought it all at one time.

Q. How many shares of stock did you own on September 30, 1937?

A. I can't tell you exactly the number of shares, but I owned ten percent of the stock in the company.

Q. Ten percent of the stock?

A. Yes. That is my recollection.

Q. I am referring to the date of the meeting

(Deposition of August Buschmann.)
which you have testified about. A. Yes, sir.

Q. What was the reason, Mr. Buschmann, for liquidating the company and forming the new company, if you know?

A. Well, the reason was that the directors of our organization figured it was to the best interests of the [49] stockholders to do so.

Q. Were you a director? A. No, sir.

Q. Was the corporation desirous of changing its calendar year to a fiscal year basis?

A. Whether the directors were desirous?

Q. Yes. A. Well, I suppose they were.

Q. Well, you understood, did you not, Mr. Buschmann, that a new corporation was to be formed, and you were going to get stock in the new corporation for your stock, if you so desired?

A. If we wanted to, yes.

Q. When did you sign your subscription for stock in the new corporation?

A. I can't tell you that.

Q. Well, was it before September 30?

A. Well, I am sorry; I can't tell you that at the present time.

Q. Well, was it before the meeting or after the meeting?

A. When I subscribed for the stock in the new corporation you say?

Q. Yes.

A. It must have been after the meeting, because nobody knew at the time of the meeting

(Deposition of August Buschmann.)

whether we were going to be in the new corporation or not.

Q. Isn't it a fact that on September 25, 1937, you subscribed for the capital stock of the new corporation to be formed, of The Pommerelle Company? A. Well, I couldn't say.

Q. You couldn't say? [50]

A. No, I couldn't.

Q. You wouldn't say that that was not the fact?

A. I couldn't say, because I don't recall the dates.

Mr. Winter: Do you have the subscriptions, Mr. Jones?

Mr. Jones: I am sure we have.

Mr. Winter: Do you have the subscription books here?

Mr. Jones: That would be the new company?

Mr. Winter: Of the new company.

Mr. Jones: Yes, this is the new company. (Handing a book to Mr. Winter.)

Q. (By Mr. Winter) I will show you, Mr. Buschmann, what purports to be the minutes of the first meeting of stockholders in The Pommerelle Company, held at 716 Dearborn Street, Seattle, which has been furnished by the plaintiffs' counsel. Did you sign that application?

A. I can't tell you whether I did or not.

Q. Did you sign it here?

A. My signature is not here.

Q. Did you attend the meeting, the first meeting?

(Deposition of August Buschmann.)

A. I can't even recall that at the present time.

Q. Well, you did subscribe for the stock, didn't you?

A. Yes, I subscribed. I apparently must have subscribed for the stock.

Q. I beg your pardon?

A. I must have subscribed for the stock, or else I wouldn't have gotten it.

Q. It shows that you are a stockholder of the corporation; [51] it recites that you were there, doesn't it, that you had subscribed?

Mr. Winter: Now, just a minute, gentlemen. If we are going to have a deposition, I would like to have the witness not be coached over there or suggested to.

A. Well, I suppose I was there, but I can't recall this far back whether I was there or not.

Q. When did you first learn about the plan to incorporate the new company?

A. Well, it was talked of, oh, for—I don't know—maybe for a month or two before the time that it was done; but I can't tell you definitely the exact date that it was talked about.

Q. When it was talked about, it was also stated it was desirous of obtaining a higher value for the purpose of Federal capital stock tax, wasn't it?

A. That is possible, yes.

Q. Well, wasn't it a fact, Mr. Buschmann?

A. Well, there were many things talked about.

(Deposition of August Buschmann.)

You see, this is not a corporation that I pay very much attention to. I am only a small stockholder in the corporation, and whatever the directors have——

Q. (Interrupting) You understood, did you not, that this purpose could be accomplished by liquidating the old corporation and forming the new one, and subscribing to the new one?

A. That is true, if you so desired, yes; I think that is right.

Q. Well, you knew you were desirous at that time, didn't you? [52]

Mr. Jones: Desirous of what?

A. Desirous of what did you say?

Q. (By Mr. Winter) I say, you were desirous at that time of getting into the new corporation? You had no intention of selling your stock, did you?

A. I had no intention of selling my stock, no.

Q. And you knew, if a new corporation was to be formed, you were going to subscribe in that?

A. Yes, that is true.

Q. Did you receive any money from the liquidation? A. Well, yes.

Q. I mean outside of this statement here, did you receive any other information with regard to it?

A. Not as far as I can recall at the present time.

Q. I am referring to the letter from the Pommerelle Company by E. Pfisterer, to you, dated February 16, 1938, and letter of February 15, 1938.

(Deposition of August Buschmann.)

A. You mean at that particular time, or before that time, or what?

Q. Well, isn't it a fact, Mr. Buschmann, that prior to September 25, 1937, it was agreed that you would liquidate the assets of the old corporation, and form a new corporation, and turn over the assets to the new corporation the same as it was in the old corporation, except you were increasing your capitalization?

A. I don't think anybody—I don't know about the rest of them, but there wasn't any specific agreement about it.

Q. There was no specific agreement about it?

A. No. [53]

Q. But it was so understood, wasn't it?

A. Well, it was talked about, yes.

Q. Yes. Were you present at the meeting of October 4, 1937, of the new company?

A. I can't recall right now whether I was or not.

Q. Well, did you give your proxy to anyone?

A. I can't recall that either.

Q. Well, during any of that time, did you attend all the meetings, or who did you give your proxies to?

A. I didn't attend all the meetings. Sometimes perhaps I gave proxies to Mr. Braicks and sometimes to Mr. Molz.

Q. What is your business, Mr. Buschmann?

A. Canning salmon.

(Deposition of August Buschmann.)

Q. Did Mr. Braicks tell you that he was prepared to buy anyone out who wanted to get out?

A. He did.

Q. That was understood prior to September 25, 1937, wasn't it?

A. Well, at the time we had the meeting there, whenever the date of that meeting was. I can't recall now.

Q. He was prepared to buy out in September, wasn't he, I mean September 25, 1937?

A. If that was the date of the meeting, that is the time that that was mentioned, yes.

Q. Who did you get the information from about the reorganization or the liquidation of the corporation? Mr. Scott?

A. I think it was discussed by several of the directors before the time it actually took place. [54]

Q. Was Mr. Scott a director?

A. I don't recall whether he was or not. Were you a director at the time?

Q. Was Mr. Scott present at these meetings?

A. Perhaps at some of them, and some of them he wasn't.

Q. Mr. Scott is the accountant for the corporation, isn't he, was or still is?

A. I don't know whether he still is. He was.

Q. He was at that time? A. Yes.

Q. Did he advise the directors and the stockholders present at the meeting that these purposes

(Deposition of August Buschmann.)
could be accomplished by a liquidation and the formation of a new corporation with a higher capital stock?

Mr. Jones: I think that when you say "these purposes", you ought to specify what purposes you mean, so that the witness will understand.

Q. (By Mr. Winter) Well, did Mr. Scott advise the stockholders in your presence, and you as a stockholder, that the corporation was desirous of changing its calendar year to a fiscal year?

A. Well, I can't recall that.

Q. Well, did he advise you that——

A. (Interrupting) I will tell you in a few short words what I recall. He advised us that this could be done legally.

Q. This could be done legally?

A. Yes, he did.

Q. What could be done legally?

A. This reorganization. If you want to organize a new [55] company, if you want to dissolve the old company and organize a new company, that could be done legally.

Q. Why were you organizing a new one?

A. Because the directors figured it was for the best interests, as I have told you.

Q. To reorganize a new company or form a new company?

A. Not reorganize a new company. Dissolve the old company and organize a new company.

Q. And it could be accomplished by the same

(Deposition of August Buschmann.)
stockholders taking the same interest in the new corporation, is that right?

A. That wasn't the point. We didn't know who were going to be in the new corporation and who weren't.

Q. You didn't know of anyone that didn't want to be in the new corporation, did you?

A. Well, I didn't know the other stockholders.

Q. You didn't know any of them at all?

A. I knew some of them, yes, but I didn't know them all, intimately.

Q. Didn't you sign a subscription for stock?

A. I suppose I did. I don't recall.

Mr. Winter: I make demand on Mr. Jones, do you have a signed subscription for stock?

Mr. Jones: Well, I have only what is in the minute book there.

The Witness: I don't recall whether there was a subscription list or not.

Q. (By Mr. Winter) Calling your attention to the first meeting, the minutes of the first meeting of the stockholders of The Pommerelle Company, wherein it appears [56] that those present, representing the number of shares subscribed for, set opposite their names, were, among others, August Buschmann, 6,000 shares. Now, I will ask you whether or not you subscribed for stock at that time.

Mr. Jones: I suggest you show the witness the minutes you are referring to, so he can tell whether

(Deposition of August Buschmann.)
he knows about it.

The Witness: Did I sign the subscription list here?

Q. (By Mr. Winters) Just answer my question, Mr. Buschmann. You don't know, is that your answer?

A. I don't know if I did. If my name is there as doing so, I suppose I did.

Q. All right.

A. I know I got the stock, so I must have subscribed for it. Whether I signed a written subscription list or not, I can't tell you.

Q. Showing you what purports to be a subscription for common stock of The Pommerelle Company, in the minute books of the new corporation, I will ask you whether or not that is your signature appearing thereon?

A. That is my signature.

Q. Where it appears that you subscribed for 6,143 shares?

A. That is my signature right there, yes, sir.

Q. Well, now, does that refresh your memory? Did you or did you not, on September 25, 1937, subscribe for 6,143 shares?

A. That is my signature there on that document.

Q. That was five days before the new corporation, the [57] First meeting of the new corporation, of the stockholders?

A. I can't say anything as regards to that.

(Deposition of August Buschmann.)

Q. Well, then, as I understand your testimony, Mr. Buschmann, you were advised by the accountant and by others in the corporation that the legal steps could be taken to accomplish the purposes of increasing the capitalization, at least, is that right?

A. Well, they figured that was for the best interests of the corporation. That is the way it was put up to us.

Q. That it was for the best interests of the old corporation? A. Of the stockholders.

Q. Yes.

A. If the stockholders didn't like it, why whoever wanted to could get out.

Q. Now, just a moment; there is no question before you.

Mr. Jones: That is a part of his answer.

Mr. Winter: I submit that, after three minutes, you can't start answering, volunteering something.

Mr. Jones: It wasn't three minutes, and let the witness answer. If you have anything more you want to add to it, Mr. Buschmann, say so.

Mr. Winter: This next remark is hard to understand. I think it was talk going on between other parties in the room.

Mr. Jones: There were four or five people there.

Mr. Winter: (Reading) The Witness: No, that is all, just that we had the privilege of withdrawing if [58] we wanted to, or we had the privilege of staying in, whichever we liked.

(Deposition of August Buschmann.)

If the Court please, I think that part, the voluntary statement, should not be considered part of the deposition. There was no question before the witness. I don't think the case is going to rise or fall on that, but I think, in all propriety, we will object to the voluntary statement.

Mr. Jones: The last question asked was a very indefinite question. The question was, "That it was for the best interests of the old corporation"? This is continuing along——

Mr. Winter: (Interrupting) According to your suggestion. If you want to add something, say "yes."

The Court: The first answer is voluntary?

Mr. Winter: Yes.

Mr. Jones: Just repetition.

The Court: I will overrule the objection.

Q. (By Mr. Winter) But to your knowledge, no one withdrew?

A. I don't think so. I don't know how many small stockholders there were that did or didn't.

Q. Do you mean to tell me that the officers or directors or Mr. Scott didn't tell you the purpose of the reorganization, or the liquidation and formation of the new corporation? (This question is verbatim from the deposition. Reporter's note)

A. I can't remember all these things four or five years back.

Q. It was discussed two or three months before, is that right? [59]

(Deposition of August Buschmann.)

A. It was discussed some time before, yes.

Q. You knew the corporation was paying high excess profits tax because of the small capitalization, didn't you, or was liable?

A. I didn't pay any particular attention to it. I told you before that I was a small stockholder, and I wasn't paying very much attention to that company. I have told you that once.

Q. Well, tell it to me again, then.

A. All right.

Q. What was the basis which Mr. Braicks advised you that he was prepared to buy anyone out? Upon what basis did he say that?

A. I can't recall the exact basis right now.

Q. Was it so much a share?

A. I think it was on a share basis, yes. I think that is right.

Q. Did you ever dispose of any of your stock, or have you disposed of any of your stock since?

A. No, I have not.

Q. You still are a stockholder in the corporation? A. Yes, sir.

Mr. Winter: That is all.

Mr. Jones: That is all, Mr. Buschmann.

(Witness excused.)

Mr. Winter: Do you want his return now? We can put them all in at once.

The Court: It is 12:00 o'clock. We will recess until 1:15. Adjournment. [60]

Afternoon Session,

January 13th, 1942.
1:15 o'clock.

The Court: You may proceed.

Mr. Jones: Does Your Honor wish me to go ahead with the depositions or shall I start with the more logical end of the case?

The Court: Whichever you prefer.

Mr. Jones: I think I had better take the testimony. These are really cumulative matters.

I will call Mr. Molz.

Mr. Winter, do you have copies of the 90-day letter and plaintiffs' return in this case?

Mr. Winters: I have certified, photostatic copies of each.

Mr. Jones: Do you object to my using a copy?

Mr. Winters: No.

Mr. Jones: For the purpose of showing the basis on which this assessment was made, not proof of the statements contained in it, I offer in evidence Plaintiff's Exhibit No. 1, Certified Copy of the 90-day letter, or assessment letter.

Mr. Winter: No objection.

The Court: Admitted.

(Plaintiffs' exhibit No. 1, the 90-day letter just referred to—Admitted in evidence.)

PLAINTIFFS' EXHIBIT No. 1

UNITED STATES OF AMERICA
Treasury Department
Washington

February 7, 1941

Pursuant to the provisions of Section 661, Chapter 17, Title 28 of the United States Code (Section 882 of the Revised Statutes of the United States), I hereby certify that the annexed is a true copy of copy of letter dated January 16, 1940 (with statement attached, minus form of waiver mentioned therein), to Pommerelle Company, Inc., Seattle, Washington, from Guy T. Helvering, Commissioner, on file in this Department.

In Witness Whereof, I have hereunto set my hand, and caused the seal of the Treasury Department to be affixed, on the day and year first above written.

By direction of the Secretary of the Treasury:

[Seal] S. H. MARKS
Chief Clerk, Treasury
Department.
S S F J P W H

SN-IT-3

District of Washington

Seattle, Washington
January 16, 1940

350 Federal Office Building
Seattle Division

IT:90D:JW

Pommerelle Company, Inc.
716 Dearborn Street
Seattle, Washington.

Sirs:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1937 discloses a deficiency of $7,346.34 and that the determination of your excess-profits tax liability for the year mentioned disclosed a deficiency of $144.62 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward

it to the Internal Revenue Agent in Charge, 350 Federal Office Building, Seattle, Washington. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY T. HELVERING
Commissioner.
By GEO. C. EARLEY
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver.
JW-ro

STATEMENT

IT:90D:JW

POMMERELLE COMPANY, INC.
716 Dearborn Street
Seattle, Washington

Tax Liability for the Taxable Year
Ended December 31, 1937

	Liability	Assessed	Deficiency
Income Tax	$12,243.93	$4,897.59	$7,346.34
Excess-profits Tax	3,903.75	3,759.13	144.62
Total	$16,147.68	$8,656.72	$7,490.96

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated March 14, 1939; to protest dated April 27, 1939 and to statements made in conferences held August 1, 1939, September 8, 1939, November 27, 1939 and December 7, 1939.

A copy of this letter and statement has been mailed to your representative, H. L. Scott, Insurance Building, Seattle, Washington, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

No taxable dividends having been paid to stockholders during the period January 1 to October 4, 1937, a dividends paid credit is not allowable.

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return		$44,143.08
Unallowable deductions and additional income:		
(a) Cost of improvements	$530.16	
(b) Organization expenses	675.00	1,205.16
Net income adjusted		$45,348.24

EXPLANATION OF ADJUSTMENTS

(a) The cost of improvements in the amount of $568.03 less $37.87 held to be allowable as depreciation on such improvements are disallowed because benefits from the expenditures were not limited to the taxable year.

(b) Expenses incurred in connection with re-

organization, recapitalization or corporate organization are not deductible from net income. Fees paid out in connection with such matters totalling $675.00 were deducted and are disallowed under the provisions of Article 24-2, Regulations 94.

COMPUTATION OF TAX

Excess-Profits Tax:	
Taxable net income	$45,348.24
Less: 10% of $102,535.97 value of capital stock as declared in your capital stock tax return for the year ended June 30, 1937	10,253.60
Net income subject to excess-profits tax	$35,094.64
5% of declared value of capital stock	5,126.80
Balance	$29,967.84
Excess-profits tax:	
6% of $5,126.80	$ 307.61
12% of $29,967.84	3,596.14
Total excess-profits tax	$ 3,903.75
Excess-profits tax assessed:	
Original—list. Account No. 4-400329	3,759.13
Deficiency—of excess-profits tax	$ 144.62
Income Tax	
Normal Tax:	
Taxable net income	$45,348.24
Less: Excess-profits tax (paid or accrued)	3,903.75
Net income for normal tax computation	$41,444.49
Normal tax net income	$41,444.49
8% of $ 2,000.00	$ 160.00
11% of $13,000.00	1,430.00
13% of $25,000.00	3,250.00
15% of $ 1,444.49	216.67
Total normal tax	$ 5,056.67

Surtax on Undistributed Profits:		
Taxable net income		$45,348.24
Less: Excess profits tax (paid or accrued)	$3,903.75	
Normal tax	5,056.67	8,960.42
Adjusted net income		$36,387.82
Subject to surtax		$36,387.82
7% of $ 5,000.00		$ 350.00
13% of 3,638.78		436.65
17% of 7,277.56		1,237.19
22% of 7,277.56		1,601.06
27% of 13,193.92		3,562.36
Total surtax		$ 7,187.26
Normal tax		5,056.67
Total income tax assessable (normal tax and surtax)		$12,243.93
Income tax assessed (normal tax and surtax):		
Original—list. Account No. 4-400329		4,897.59
Deficiency of income tax		$ 7,346.34

Mr. Jones: I also offer in evidence copy of the [61] return of the Pommerelle Company for the year 1937—certified copy.

Mr. Winter: No objection.

The Court: Admitted.

(Plaintiffs' exhibit No. 2, return of the Pommerelle Company for the year 1937, Admitted in evidence.)

PLAINTIFF'S EXHIBIT No. 2

POMMERELLE COMPANY, INC.

FIXED ASSETS AND DEPRECIATION

January 1, 1937 to October 4, 1937

Schedule K
Page 1

	Date Acquired	Cost	Depreciation Reserve 12-31-36	Remaining Cost	Life Used	Life Remaining Years	Life Remaining From	Depreciation 1937 to 10-4-37	Depreciation Reserve 10-4-37
Building									
Brick Veneer—3 Story—Built 1909	6-1-37	$21,992.12		$21,992.12	40 Years	12 Years	6-1-37	$632.65	$ 632.65
New Simplex Oil Burner	8-20-37	459.00		459.00	12 Years	11¾ Years	9-1-37	3.68	3.68
		22,451.12		22,451.12				636.33	636.33
Machinery and Equipment									
Champagne Bottling Machine	March 1934	400.71	$163.62	237.09	5 Years			60.81	224.43
Seitz Filter	August 1934	562.82	212.99	349.83	5 Years			85.41	298.40
Cider Press	September 1934	485.61	181.25	304.36	5 Years			73.70	254.95
Pump and Motor	October 1934	53.70	19.77	33.93	5 Years			8.15	27.92
Corker	May 1934	5.00	1.36	3.64	5 Years			.76	2.12
Corker	May 1935	2.25	.61	1.64	5 Years			.34	.95
Crimping Machine	May 1935	4.80	1.30	3.50	5 Years			.73	2.03
Tape Machine	July 1935	5.00	1.26	3.74	5 Years			.76	2.02
Label Gluer	December 1935	60.00	12.00	48.00	5 Years			9.11	21.11
Grape Crusher	December 1935	80.00	16.00	64.00	5 Years			12.14	28.14
Loeb Filter Machine and Plates	December 1935	420.00	87.30	332.70	5 Years			63.77	151.07
Rotary Pump	December 1935	55.86	11.17	44.69	5 Years			8.47	19.64
Capping Machine	February 1936	5.00	.83	4.17	5 Years			.76	1.59
Bottling Machine	April 1936	7.00	.93	6.07	5 Years			1.06	1.99
¼ H. P. Motor	April 1936	3.50	.47	3.03	5 Years			.53	1.00
Loeb Filter	August 1936	185.00	12.33	172.67	5 Years	4 8/12 Years	1-1-37	12.33	24.66
Sold May 1, 1937		185.00							24.66
Heating Equipment	September 1936	53.89	2.70	51.19	5 Years			8.18	10.88
Pump	October 1936	95.00	3.17	91.83	5 Years			14.37	17.54
Capping Machine	November 1936	11.00	.15	10.85	5 Years			1.67	1.82
Label Gluer	November 1936	60.00	1.00	59.00	5 Years			9.11	10.11
Pump Unit and Freight	December 1936	141.68		141.68	5 Years			21.50	21.50
#1910 Wire Filter	January 1937	1,252.56		1,252.56	7 Years			135.86	135.86
#1 Hydraulic Press	January 1937	1,328.04		1,328.04	7 Years			143.97	143.97
Lifter Truck	April 1937	71.40		71.40	5 Years			7.32	7.32
Platform Scale	May 1937	10.00		10.00	5 Years			.86	.86
Pasteurizer	May 1937	25.50		25.50	5 Years			2.19	2.19
Hand Trucks	June 1937	40.00		40.00	5 Years			2.76	2.76
Crane Co. Thermostatic Tank	July 19, 1937	65.69		65.69	5 Years			2.77	2.77
Moran Mfg. Co.—2x2½" Pump	July 24, 1937	141.37		141.37	5 Years			5.58	5.58
L. H. Butcher Seitz Filter & Plates	Sept. 16, 1937	704.57		704.57	5 Years			6.94	6.94
De Laval Type E. H. Viking Pump	Sept. 21, 1937	63.24		63.24	5 Years			.45	.45
De Laval Motor	October 4, 1937	46.00		46.00	5 Years				
Palmer Supply Co.--Bronze Pump--Mounted	October 4, 1937	102.60		102.60	5 Years				
		$6,363.79	$730.21	$5,818.58				$702.36	$1,407.91

Schedule K
Page 2

	Date Acquired	Cost	Depreciation Reserve 12-31-36	Remaining Cost	Life Used	Life Remaining Years	Life Remaining From	Depreciation 1937 to 10-4-37	Depreciation Reserve 10-4-37
Tanks and Puncheons									
30 Puncheons	September 1934	$ 265.85	$ 99.23	$ 166.62	5 Years			$ 39.59	$ 138.82
Sold 6-14-1937—3 Puncheons		26.58							13.88
Sold 7-27-1937—7 Puncheons		62.03							32.39
Sold 8-23-1937—6 Puncheons		53.17							27.76
35 Puncheons	October 1934	325.50	119.87	205.63	5 Years			49.37	169.24
7 Puncheons	November 1934	55.46	20.16	35.30	5 Years			8.41	28.57
5 Puncheons	December 1934	54.80	19.68	35.12	5 Years			8.32	28.00
9 Puncheons	March 1935	93.78	26.85	66.93	5 Years			14.23	41.08
10 Puncheons	November 1935	91.54	19.83	71.71	5 Years			13.89	33.72
10 Puncheons	December 1935	91.54	18.69	72.85	5 Years			13.89	32.58
10 Puncheons	January 1936	137.05	25.13	111.92	5 Years			20.80	45.93
20 Puncheons	February 14, 1936	137.75	22.96	114.79	5 Years			20.90	43.86
1—1000 gal. Fermenting Tank	February 14, 1936	52.20	8.70	43.50	5 Years			7.92	16.62
10 Puncheons	March 30, 1936	92.00	13.80	78.20	5 Years			13.96	27.76
4—1000 gal. Fermenting Tanks	August 1, 1936	214.74	14.32	200.42	5 Years			32.73	47.05
2—1000 gal. Tanks	January 1937	133.41		133.41	5 Years			21.34	21.34
2—5000 gal. Tanks	January 1937	367.05		367.05	5 Years			55.71	55.71
3—5000 gal. Tanks	January 1937	636.10		636.10	5 Years			96.55	96.55
6—7x9 Horizontal Tanks	March 1937	1,014.78		1,014.78	5 Years			121.22	121.22
3—16 gal. Bbl. Tanks	March 1937	114.24		114.24	5 Years			13.64	13.64
2—7x11-2670 gal. Horizontal Tanks	April 1937	335.66		335.66	5 Years			34.39	34.39
2—4000 gal. Tanks	April 1937	450.32		450.32	5 Years			46.14	46.14
1—5000 gal. Tanks	April 1937	223.70		223.70	5 Years			22.92	22.92
2—7-9 Horizontal Tanks	May 1937	295.00		295.00	5 Years			25.38	25.38
1—5x7—1000 gal. Mixing Tank	May 1937	60.05		60.05	5 Years			5.17	5.17
5—2940 gal. Tanks	June 1937	877.04		877.04	5 Years			60.55	60.55
1—2500 gal. Fortifying Tank	August 1937	143.86		143.86	5 Years			5.09	5.09
130 Puncheons Abandoned		1,203.49							515.53
		$4,918.15	$409.22	$5,854.20				$752.11	$ 571.77
Delivery Equipment									
White Truck	2-20-36	40.80		40.80	Junk Value				
Traded on G. M. Truck	9-13-37	40.80							
Chevrolet Truck	6- 1-37	810.74		810.74	4 Years			64.48	64.48
1930 Kenworth Truck	9- 7-37	229.50		229.50	2 Years			8.80	8.80
1937 General Motors 1½ Ton Truck	9-13-37	1,106.60		1,106.60	5 Years			12.73	12.73
		$2,146.84		$2,187.64				$ 86.01	$ 86.01

Schedule K
Page 3

	Date Acquired	Cost	Depreciation Reserve 12-31-36	Remaining Cost	Life Used	Life Remaining Years	Life Remaining From	Depreciation 1937 to 10-4-37	Depreciation Reserve 10-4-37
Furniture and Fixtures									
Burroughs Adding Machine	December 1936								
2 Desks & 2 Chairs	May 1937	$ 28.00		$ 28.00	5 Years			$ 4.25	$ 4.25
Typewriter	June 4, 1937	50.49		50.49	5 Years			4.34	4.34
Large Table	July 20, 1937	25.00		25.00	5 Years			1.67	1.67
Small Table	July 20, 1937	5.10		5.10	5 Years			.21	.21
Large Table and 8 Chairs	July 20, 1937	4.08		4.08	5 Years			.17	.17
12 Chairs	July 20, 1937	15.30		15.30	5 Years			.64	.64
Filer Register	August 3, 1937	24.48		24.48	5 Years			1.01	1.01
1 Desk	August 3, 1937	34.50		34.50	5 Years			1.17	1.17
1 Letter File	August 3, 1937	12.75		12.75	5 Years			.43	.43
Reception Room Furniture	August 25, 1937	15.30		15.30	5 Years			.52	.52
Reception Room Lights	August 25, 1937	135.43		135.43	5 Years			2.97	2.97
Reception Room Linoleum	August 30, 1937	51.53		51.53	5 Years			1.13	1.13
Rubber Matting—Hall and Stairs	August 31, 1937	39.29		39.29	5 Years			.42	.42
Furnishings	September 4, 1937	50.92		50.92	5 Years			.95	.95
Check Writer	September 13, 1937	59.61		59.61	5 Years			.98	.98
Victor Adding Machine	September 23, 1937	22.50		22.50	10 Years			.13	.13
2 Chairs	September 27, 1937	178.50		178.50	10 Years			.53	.53
Switchboard Table	October 4, 1937	3.06		3.06	5 Years				
Roll Top Desk	October 4, 1937	13.46		13.46	5 Years				
Refrigerator	October 4, 1937	15.30		15.30	5 Years				
Furnishings	October 4, 1937	50.49		50.49	10 Years				
		7.95		7.95	5 Years				
		$ 843.04		$ 843.04				$ 21.52	$ 21.52

Statement of facts covering the dissolution of Pommerelle Company, Inc., a Corporation.

1. Date of dissolution October 4, 1937.
2. Exact steps taken to dissolve the corporation.
3. Date the distribution was paid to the stockholders October 4, 1937.
4. Name and address of each stockholder at time of dissolution: See attached schedule.

   Number and Par Value of Shares of Stock of Each: 25,500 Shares, $25,500.00.

   Amount of money received by each during course of dissolution..........

   Amount and return of other Assets Received by each during course of dissolution $61,423.39
5. List the names and addresses of each individual or corporation other than shareholders and creditors, if any that received assets at dissolution and the amount or value received by each.
6. If any consideration was paid for any of the assets, state the name and address of the individual or corporation making such payments and the exact amount paid by each.
7. If any money or property remains undistributed, state the amount, nature and value of the same and why it has not been distributed. (If additional space is required use separate sheet).

POMMERELLE COMPANY, INC.

(Signature)

W. BRAICKS,

Pres.

POMMERELLE COMPANY, INC.

DISTRIBUTION OF CAPITAL AND SURPLUS
At October 4, 1937

Name and Address of Each Stockholder at Time of Dissolution		Number of Shares of Stock of Each	Par Value of Shares of Stock of Each	Value of Assets Received by Each During Dissolution
A. Vanderspek	Seattle	5,100	$ 5,100.00	$12,284.68
W. Braicks	Seattle	4,250	4,250.00	10,237.23
J. G. Molz	Seattle	3,655	3,655.00	8,804.12
Eleanor Pfisterer	Seattle	2,975	2,975.00	7,166.05
August Buschmann	Seattle	2,550	2,550.00	6,142.34
Fred W. Wonn	Seattle	1,700	1,700.00	4,094.87
Gilbert Kroll	Seattle	850	850.00	2,047.44
J. Kangley	Seattle	850	850.00	2,047.44
C. S. Leede	Seattle	425	425.00	1,023.72
Wm. E. Leede	Seattle	850	850.00	2,047.43
Dorothy Leede	Seattle	850	850.00	2,047.43
Eleanore Leede	Seattle	850	850.00	2,047.43
E. A. Hulitz	Seattle	595	595.00	1,433.21
		25,500	$25,500.00	$61,423.39

Mr. Jones: I think there is nothing about this that becomes of a great deal of significance, unless we have occasion to refer to the figures and computation, except it shows the claim for deduction of the amount distributed, of the dividends paid, and attached to the return there is a liquidating statement which is the ordinary form of liquidation return that is filed, together with the list of the shareholders and amounts distributed to them.

Mr. Winter: There is a claim for refund, Mr. Jones, with the letter of rejection.

Mr. Jones: Yes, for the fiscal year ending October 4, 1937. We might as well put in the claim for refund, if Counsel has no objection, and letter of rejection, as Plaintiffs' Exhibit No. 3.

Mr. Winter: No objection.

The Court: Admitted.

(Plaintiffs' exhibit No. 3, claim for refund and letter of rejection, admitted in evidence, and made a part of the record herein.)

Mr. Winter: We also have the certificate of assessment and payments, Mr. Jones. [62]

Mr. Jones: Well, if you have them there. I don't have that information. Counsel has furnished me with a certified copy of the certificate of assessment and payments, which I will offer as Plaintiffs' exhibit No. 4.

The Court: It may be admitted.

(Plaintiffs' exhibit No. 4, certified copy certificate of assessment and payments, Admitted in evidence.)

Mr. Jones: I also file at this time notice to the plaintiffs asking for the production of certain tax returns which will be called for and produced under our arrangement, as we carry on the case; and, also, a request for admissions which has been answered to the effect that the defendant has no information on which to base an answer. I think that is, substantially, the effect of the answer.

J. G. MOLZ,

called as a witness on behalf of the plaintiffs herein, being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. Now, Mr. Molz, will you state your name?

A. J. G. Molz.

Q. Do you live in Seattle? A. I do.

Q. Were you connected with the concern called, originally, "The Malic Company" and subsequently known as "The Pommerelle Co." or "The Pommerelle Company, Inc."? A. I was. [63]

Q. We will call that afterwards, "the Old Company." And, have you been connected since along in October 1937 with the Pommerelle Company, which is now operating? A. I have.

Q. In what capacities were you connected with those two companies?

A. At the very beginning I was Secretary and Treasurer and for a short time, I was only Secretary, and at the present time I am Secretary and Treasurer again.

Q. You have been Secretary of each of those companies during their existence, have you?

A. I have.

Q. And are now the Secretary? A. Yes.

Q. And you have produced here today these two Minute Books which are Minute Books of the Company, is that it? A. Yes.

Q. Which have been in your custody?

(Testimony of J. G. Molz.)

A. Yes.

Q. Now, what business was the old company engaged in, the Pommerelle?

A. At the very beginning, we decided to produce groceries, and as soon as our prohibition law changed, it was possible for us to enter into the production of wines. At the present time, we produce wines and liquors, both.

Q. Do you recall the steps taken in September and October 1937 with reference to certain steps winding up the old company and forming the new one? I will refer you, specifically, to the Minutes. I will just ask you if you remember that occasion? [64] A. Yes, I do.

Q. Just tell us what you recall of the purposes and occasion for carrying out that transaction?

A. Our company experienced a rather spectacular growth, since 1934. We, naturally, had to file our financial papers, et cetera, at the bank from time to time and it was decided in due time to increase our capitalization and our declared value also, and, as I recall it, that was one of the prime reasons at the time for liquidating the old company.

Q. Was there any person, in particular, who assumed responsibility for the liquidation, undertook to carry it out?

A. Well, it was expalined to our accountant at the time and tax consultant, that we were facing various problems; for instance, the taxes, and naturally, financial problems—because every cent the

(Testimony of J. G. Molz.)

company was making at the time was constantly put back in the inventory, so if we were called upon to meet our obligations, particularly our tax obligations, we had to go to the bank and borrow money.

Q. And who was your accountant that you consulted?

A. Harold Scott & Company.

Q. I show you the Minute Book of the Pommerelle Company, Inc. and ask you if you identify this as the Minute Book of that Company?

A. I do.

Q. I don't know how much of this Counsel may want to refer to. I have submitted the book to Counsel. If it were agreeable, I will just offer the entire book in evidence, with leave to call attention to any pertinent parts. Is that agreeable to you? [65]

Mr. Winter: That is agreeable.

The Court: All right.

Mr. Winter: I made copies, Mr. Jones. I don't believe we kept a copy of that. (Indicating)

Mr. Jones: I don't think so.

Mr. Winter: That is right. That is right.

The Court: Do you offer it, Mr. Jones?

Mr. Jones: Yes, I offer this as ——?

The Clerk: Plaintiffs' exhibit No. 5.

Mr. Winter: We reserve the right to object to matters immaterial to the case, if the Court please.

The Court: All right, subject to that reservation, as you refer to it.

(Testimony of J. G. Molz.)

Mr. Winter: I haven't read it, Your Honor.

(Plaintiffs' Exhibit No. 5, the Minutes just referred to, admitted in evidence.)

PLAINTIFFS' EXHIBIT No. 5

CALL AND WAIVER OF NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

POMMERELLE COMPANY, INC.,

We, the undersigned stockholders of "Pommerelle Company, Inc.," hereby call a special meeting of stockholders of this company to be held in the main office of the Company on September 30, 1937 at 10:00 A.M., for the purpose of acting on a Resolution for the voluntary dissolution of this company out of court and the appointment of Trustees for the purpose of winding up the affairs of this corporation in manner provided by law for voluntary dissolution of corporations.

We hereby waive all statutory and by-law requirements as to notice of time, place and purpose of said meeting and consent to the transaction of any business properly brought before said meeting.

W. BRAICKS
F. W. WONN
J. G. MOLZ
E. PFISTERER
J. C. KANGLEY
AUGUST BUSCHMANN
A. VANDERSPEK

(Testimony of J. G. Molz.)

E. PFISTERER
G. M. KROLL
C. S. LEEDE
ELEANOR M. LEEDE
DOROTHY LEEDE
WM. E. LEEDE

"MINUTES OF SPECIAL MEETING OF STOCKHOLDERS OF 'POMMERELLE COMPANY, INC.,' SEPTEMBER 30, 1937

"A Special Meeting of Stockholders of 'Pommerelle Company, Inc.,' was held in the registered office of the Company in Seattle Washington, September 30, 1937, at 10:00 A.M., pursuant to the foregoing Call and Waiver of Notice, which provided that the principal business to come before said meeting would be a resolution providing for the voluntary dissolution of the company.

"All stockholders appearing on the books of the company and entitled to Notice and to vote at such meeting were present in person or represented by proxy.

"After discussion the following Resolution was duly presented and on proper action unanimously adopted:—

" 'Resolved that W. Braicks and J. G. Molz, be and they hereby are appointed as Trustees to wind up and liquidate the assets and affairs of this company and are authorized to execute

(Testimony of J. G. Molz.)

all papers and documents required in connection with the voluntary liquidation and dissolution of this corporation out of Court.'

"The meeting thereupon adjourned subject to call by W. Braicks and J. G. Molz.

J. G. MOLZ
Secretary

Attest

W. BRAICKS
President."

MINUTES OF SPECIAL MEETING OF STOCKHOLDERS OF "POMMERELLE COMPANY, INC.," HELD OCTOBER 4, 1937

A Special Meeting of Stockholders of "Pommerelle Company Inc., was held in the principal registered office of the company in Seattle, Washington on October 4, 1937 at 10:00 A.M. pursuant to call by W. Braicks and J. G. Molz as provided at the meeting of Stockholders on September 30, 1937.

All stockholders appearing on the books of the company and entitled to notice and to vote at such meeting were present in person or represented by proxy.

W. Braicks and J. G. Molz, appointed at the meeting of September 30, 1937 as Trustees to liquidate and wind up the affairs of the company reported as follows:—

(Testimony of J. G. Molz.)

That they had liquidated the assets and affairs of the company by distributing the same to stockholders of record in undivided portions in the amounts set opposite their names as follows:

Stockholder	Amount of Liquidation
A. Venderspek	$12,284.68
W. Braicks	10,237.23
J. G. Molz	8,804.02
Eleonore Pfisterer	7,166.05
August Buschmann	6,142.34
Fred W. Wonn	4,094.89
Gilbert Kroll	2,047.45
J. Kangley	2,047.45
C. S. Leede	1,023.72
Wm. E. Leede	2,047.45
Dorothy Leede	2,047.45
Eleonore M. Leede	2,047.45
E. A. Hulitz	1,433.21
	$61,423.39

The following Resolution was thereupon unanimously adopted:

"Resolved that the stockholders of Pommerelle Company, Inc., hereby approve the actions of W. Braicks and J. G. Molz acting as Trustees for the liquidation of the company, and accept their proportionate shares of the assets of said company."

The meeting thereupon adjourned.

J. G. MOLZ,
Secretary

Attest

W. BRAICKS,
President.

(Testimony of J. G. Molz.)

Q. I call your particular attention, Mr. Molz, to the Minutes of the meeting, the special meeting of Stockholders September 30, 1937, at which time the following resolution was adopted: "Resolved that L. H. Braicks and J. G. Molz be and hereby are appointed as trustees to wind up and liquidate the assets and affairs of this Company and are authorized to execute all papers and documents required in connection with the voluntary liquidation and dissolution of this corporation out of Court". Were you one of those trustees named there? A. Yes, I was.

Q. What did you do pursuant to that resolution as trustee?

A. As far as I remember, I executed the terms of the resolution. [66]

Q. In what way, do you remember specifically?

A. I really couldn't give you the details, Mr. Jones; I know we were constantly working with the Company who made up all our reports at the time and he, knowing the purpose——

Mr. Winter (Interrupting): I object to the witness testifying what Mr. Scott knew.

Q. Do you recall the meeting at which the resolution to liquidate was adopted, that I have just read? A. Yes.

Q. State whether or not there was any discussion at that meeting or approximately that time, with regard to who should become stockholders of a new corporation that was to carry on?

(Testimony of J. G. Molz.)

A. No, nothing was said.

Q. There was nothing said at that meeting?

A. No.

Q. Was anything said any time prior to the meeting about that?

A. Not that I know of.

Q. Was there anything said as to the relative—to the possibility of any of the stockholders of the old company disposing of their stock?

A. Well, it was very difficult to talk to all of them——

Mr. Winter (Interrupting): I object to that as not responsive.

Mr. Jones: Well, that was simply preliminary, I think.

A. I can't very well put it all in one sentence; this particular question is rather hard to explain. Some of the stockholders who lived in Seattle were available and [67] they could express their opinions, they were told about the idea we had in mind and, of course, didn't express the idea—possibly they agreed to it; possibly, they didn't. I just happened to be an officer in the company and followed the instructions of the stockholders.

Q. Well, do you recall any discussions with stockholders as to whether or not they might or might not dispose of their stock in the old company and not go into the new?

A. I didn't go so far, no, I didn't discuss those matters with them.

(Testimony of J. G. Molz.)

Q. You didn't discuss those matters with them?

A. No, I didn't.

Q. Now, you recall the steps taken to form the new company, do you? A. Yes, I do.

Q. And you have identified this, which I will offer as Plaintiff's 6, as the Minute Book of the new company? A. Right.

Mr. Jones: May we offer it? I will offer it on the same understanding as the Minute Book of the old Company.

Mr. Winter: No objection, except for any matters therein contained which are irrelevant and immaterial.

The Court: It may be admitted with that understanding.

(Plaintiffs' Exhibit 6, the Minute Book just referred to, admitted in evidence.)

PLAINTIFF'S EXHIBIT No. 6

Call and Waiver of Notice of First Meeting of Stockholders

We, the undersigned, being all of the incorporators and subscribers to stock of The Pommerelle Company and representing by our subscriptions more than two thirds of the subscribers to its capital stock entitled to notice of said meeting, do hereby call the First Meeting of Stockholders to be held at 716 Dearborn Street, Seattle, Washington,

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

for the organization of said corporation, election of Directors and transaction of such other business as may properly come before said meeting and hereby waive all requirements as to notice of time, place and purpose of such meeting and consent to the transaction of all business coming before said meeting.

Dated at Seattle, Washington, September 25, 1937.

W. BRAICKS,
ELEONORE PFISTERER,
J. G. MOLZ.

Minutes of First Meeting of Stockholders

The first meeting of incorporators and stockholders of The Pommerelle Company, was held at 716 Dearborn Street, Seattle, Washington at 10:30 A.M. September 25, 1937 pursuant to the foregoing Call and Waiver of Notice.

Those present, representing the number of shares subscribed for set opposite their names were:—

W. Braicks	10,000	shares
J. Molz	8,500	"
Eleonore Pfisterer	6,000	"
A. Vanderspek	12,000	"
August Buschmann	6,000	"
C. S. Leede	7,000	"

W. Braicks was elected temporary chairman and secretary of the meeting.

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

Articles of Incorporation, heretofore filed with the Secretary of State of the State of Washington, and by him approved, were presented and accepted as the Articles of Incorporation and Charter of the corporation.

A proposed code of by-laws were submitted and adopted and ordered incorporated in the records of the company.

A Seal, identified by an impression thereof on the margin hereof was adopted as the Seal of the Corporation.

[Seal]

A corporate book was adopted and is that in which these minutes appear.

The following Resolution was then unanimously adopted:—

> "Resolved, that the Directors named in the Articles of Incorporation, namely, W. Braicks, J. Molz and Eleonore Pfisterer, be accepted as the First Board of Directors of the corporation to serve until January 15, 1938 and thereafter until their successors are elected and qualified."

The following Resolution was then unanimously adopted:—

> "Resolved, that the corporation accept and adopt as corporate acts those actions heretofore taken in its name by W. Braicks, J. Molz and Eleonore Pfisterer, in the formation and organization of this corporation."

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

The meeting was thereupon adjourned, subject to call of the President.

W. BRAICKS,
Temporary Chairman and Secretary and President elect.

Attest:

J. G. MOLZ,
Secretary Elect.

Oath of Office of Directors

State of Washington,
County of King—ss.

W. Braicks, J. Molz and Eleonore Pfister, being first duly sworn on oath depose and say, each for himself and not one for another:—

That he was elected a Director of The Pommerelle Company, a Washington corporation, and designated in the Articles of Incorporation to hold office for not less than sixty days nor more than six months from date of incorporation, and having been elected to hold office until January 15, 1938, and thereafter until his successor was elected and qualified; that he will faithfully perform all the duties of said office as Director and will uphold and defend the constitution of the United States

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

and of the State of Washington to the best of his ability.

W. BRAICKS,
ELEONORE PFISTERER,
J. G. MOLZ.

Subscribed and sworn to before me this 25th day of September 1937.

[Seal] J. FORSTER,

Notary Public in and for the State of Washington, residing at Seattle.

CALL AND WAIVER OF NOTICE OF FIRST MEETING OF DIRECTORS

We, the undersigned, being all of the Directors of The Pommerelle Company, a Washington corporation, do hereby call the First Meeting of Directors to be held at 716 Dearborn Street, Seattle, Washington, September 25, 1937 at 11:00 A. M., for the purpose of electing officers and transacting any and all business pertaining to the affairs of said company and hereby waive all notice as to time, place and purpose of such meeting and consent thereto.

Dated at Seattle, Washington, September 25, 1937.

W. BRAICKS,
ELEONORE PFISTERER,
J. G. MOLZ.

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

Minutes of First Meeting of Board of Directors

The First meeting of the Board of Directors of The Pommerelle Company was held at 716 Dearborn Street, Seattle, Washington, that being the registered office of said company, at 11:00 A. M. September 25, 1937, pursuant to the foregoing Call and Waiver of Notice.

Directors present:—W. Braicks, J. Molz and Eleonore Pfisterer.

Election of officers was declared the first business of the meeting and the following officers were unanimously elected to hold office until January 15, 1938 and thereafter until their successors are elected and qualified:—

President ....W. Braicks
Vice President ....Fred W. Wonn
Secretary ....J. Molz
Treasurer ....Eleonore Pfisterer

The following Resolution was thereupon unanimously adopted:—

"Resolved, that the officers of this company are hereby authorized and directed to open proper books of account and pay from corporate funds the costs, expenses and fees incurred in the formation and incorporation of this company."

The following Resolution was thereupon unanimously adopted:—

"Resolved, That W. Braicks, President of The Pommerelle Company be and he is hereby author-

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

ized and directed to file with the Federal Alcohol Administration applications for Wine Producers and Blenders Basic Permits to the end that The Pommerelle Company, as successor to Pommerelle Company, Inc., may operate bonded wineries and storerooms in the city of Seattle, Washington, in which to manufacture, store and sell wines made from fruit and fruit juices."

"The President is further authorized to sign all applications, bonds, and other necessary papers and documents in connection therewith."

The following Resolution was thereupon unanimously adopted:—

"Resolved, That the President, or the Vice-President, or the Secretary, or the Treasurer of The Pommerelle Company be and they hereby are authorized to execute all applications, bonds, reports and other papers and documents required from time to time by the Alcohol Tax Unit of the Federal Government."

The meeting was thereupon adjourned, subject to call of the President.

J. G. MOLZ,
Secretary.

Attest:

W. BRAICKS,
President.

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

Oaths of Office of Officers

State of Washington,
County of King—ss.

W. Braicks, Fred W. Wonn, J. Molz and Eleonore Pfisterer, being first duly sworn, upon oath, each for himself and not one for another, deposes and says: That I am President, Vice President, Secretary, and Treasurer, respectively of The Pommerelle Company, elected September 25, 1937 to hold office until January 15, 1938 and thereafter until my successor is elected and qualified. That I will faithfully perform all the duties of my office and will uphold and defend the Constitution and laws of the United States and of the State of Washington to the best of my ability.

W. BRAICKS,
ELEONORE PFISTERER,
J. G. MOLZ.

Subscribed and sworn to before me this 28th day of September, 1937.

....

Notary Public in and for the State of Washington, residing at Seattle.

Subscription for Common Stock in the Pommerelle Company

We, the undersigned, hereby subscribe for the number of shares of common stock in The Pom-

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

merelle Company set opposite our signatures. Each share of common stock to have a par value of $1.00 to be fully paid and non assessable. Subscriptions all to be payable on demand.

Seattle, Washington.

	No. of Shares	Price
W. Braicks	10,238	$10,238.
J. Molz	8,805	8,805.
F. W. Wonn	4,095	4,095.
J. C. Kangley	2,048	2,048.
August Buschmann	6,143	6,143.
A. Vanderspek	12,285	12,285.
G. M. Kroll	2,048	2,048.
E. Pfisterer	7,167	7,167.
E. A. Huletz	1,434	1,434.
C. S. Leede	1,024	1,024.
Eleonore M. Leede	2,048	2,048.
Dorothy Leede	2,048	2,048.
Wm. Leede	2,048	2,048.

Seattle, Washington,
September 30, 1937.

To: The Board of Directors of "The Pommerelle Company,"
Seattle, Washington.

Gentlemen:

We, the undersigned subscribers for stock in The Pommerelle Company in the amounts set opposite our names, hereby offer to sell, assign, transfer and turn over to The Pommerelle Company in full payment of our individual subscriptions, our undivided ownerships and interests in the assets shown upon

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

the attached list, subject to all liabilities, which The Pommerelle Company is to assume and agree to pay.

W. Braicks	10,238	Shares
F. W. Wonn	4,905	
J. G. Molz	8,805	
E. Pfisterer	7,167	
J. C. Kangley	2,048	
August Buschmann	6,143	
A. Vanderspek	12,285	
E. Pfisterer	7,167	
G. M. Kroll	2,048	
C. S. Leede	1,024	
Eleonore M. Leede	2,048	
Dorothy Leede	2,048	
Wm. E. Leede	2,048	
E. A. Huletz	1,434	

POMMERELLE COMPANY, INC.

ASSETS

October 4, 1937

Current Assets			
Cash in National Bank of Commerce		$ 344.12	
Cash in Seattle-First National Bank		728.38	
Accounts Receivable		10,094.73	
Inventories:			
Finished Products	$ 4,558.19		
Goods in Process	25,347.64		
Raw Materials	32,024.44		
Supplies	531.42		
Revenue Stamps	1,020.85	63,482.54	
Total Current Assets			$ 74,649.77

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

Fixed Assets			
Land		3,696.22	
Building	22,451.12		
Less: Reserve for Depreciation	636.33	21,814.79	
Machinery and Equipment	6,363.79		
Less: Reserve for Depreciation	1,407.91	4,955.88	
Tanks and Puncheons	4,918.15		
Less: Reserve for Depreciation	571.77	4,346.38	
Delivery Equipment	2,146.84		
Less: Reserve for Depreciation	86.08	2,060.83	
Furniture and Fixtures	843.04		
Less: Reserve for Depreciation	86.01	2,060.83	
Total Fixed Assets			37,695.62
Other Assets			
Stock Subscriptions Receivable			630.15
Deferred Charges to Operations			
Lease Deposit		50.00	
Interest Paid In Advance		156.95	
Rent Paid in Advance		217.74	
Prepaid Insurance		215.60	
Total Deferred Charges to Operations			640.29
			$113,615.83

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

POMMERELLE COMPANY, INC.
LIABILITIES
October 4, 1937

Current Liabilities		
Notes Payable—Bank	$15,500.00	
Accounts Payable	2,581.43	
Accrued Federal Income Tax	9,106.72	
Accrued Salaries and Wages	1,109.28	
Accrued Interest Payable	388.36	
Accrued Old Age Benefits	54.73	
Accrued Federal Unemployment Insurance	23.16	
Accrued State Unemployment Insurance	50.33	
Accrued State Business Tax	51.65	
Accrued Real Estate Taxes	343.93	
Accrued Personal Property Taxes	452.41	
Total Current Liabilities		$29,662.00
Long Term Liabilities		
Real Estate Contract Payable		22,500.00
Other Liabilities		
Christmas Fund		30.44
Total Liabilities		$52,192.44
Total Assets		$113,615.83
Total Liabilities		52,192.44
Excess of Assets Over Liabilities		$ 61,423.39

Call and Waiver of Notice of Special Meeting of Directors of The Pommerelle Company, October 4, 1937.

We, the undersigned Directors of The Pommerelle Company, a Washington corporation, hereby

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

call a Special Meeting of the Board of Directors of said company to be held on October 4, 1937 at the Registered office of the company in Seattle, at 10:30 A. M. for the purpose of acting on the purchase of certain goods, wares, merchandise, machinery, equipment and assets for use of the company in conducting the business for which this company was formed. We hereby waive all statutory and by-law requirements as to notice of time, place and purpose of the meeting and consent to the transaction of business coming before said meeting.

W. BRAICKS,
J. G. MOLZ.
E. PFISTERER.

Minutes of Special Meeting of Directors of the The Pommerelle Company October 4, 1937

A Special meeting of the Board of Directors of this company was held at 10:30 A. M. October 4, 1937 at the registered office of the company, pursuant to the foregoing Call and Waiver of Notice.

Present were: W. Braicks, J. G. Molz, and Eleonore Pfisterer.

The first matter brought before the meeting was the offer of certain individuals to sell assets, subject to liabilities as shown by the statement of assets and liabilities attached to said offer. After consideration the following Resolution was unanimously adopted:—

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

"Resolved that this company accept the offer dated October 4, 1937, executed by a number of individuals, and purchase the assets, subject to the liabilities as shown by the statement of assets and liabilities attached to said offer, at the full purchase price of $61,423.39 and that said purchase price be fully paid by applying the amounts set opposite the names of each individual executing said offer upon the payment of their respective subscriptions for stock in this company as follows:

Subscriber	Value of Assets	Cash to Be Paid by Subscriber	Par Value of Shares to Issue
A. Vanderspek	$12,284.68	$ .32	$12,285.00
W. Braicks	10,237.23	.77	10,238.00
J. G. Molz	8,804.02	.98	8,805.00
Eleonore Pfisterer	7,166.05	.95	7,167.00
August Buschmann	6,142.34	.66	6,143.00
Fred W. Wonn	4,094.89	.11	4,095.00
Gilbert Kroll	2,047.45	.55	2,048.00
J. Kangley	2,047.45	.55	2,048.00
C. S. Leede	1,023.72	.28	1,024.00
Wm. E. Leede	2,047.45	.55	2,048.00
Dorothy Leede	2,047.45	.55	2,048.00
Eleonore M. Leede	2,047.45	.55	2,048.00
E. A. Hulitz	1,433.21	.79	1,434.00
	$61,423.39	$7.61	$61,431.00"

The Following Resolution was thereupon unanimously adopted:—

"Resolved that Seattle-First National Bank is hereby selected as the bank of and the depository for the funds of this corporation, which may be withdrawn on checks, drafts or advises of debit

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

given or signed in the corporate name by any two of the following:—

W. Braicks.......................................President
Fred W. Wonn.....................Vice-President
J. G. Molz ....Secretary
Eleonore Pfisterer ....Treasurer

each of whom is also authorized to draw and accept drafts and execute contracts and other agreements between the bank and the corporation, and to make, collect, discount, negotiate, indorse and assign, in the corporate name, all checks, drafts, notes and other paper payable to or by this corporation; and all such paper, signed as aforesaid, including checks payable to the order of any one or more of said persons or to bearer shall be honored by the bank and charged to our account. Indorsements for deposit may be made by rubber stamp and shall bind the corporation to the same effect as though signed by the properly authorized officers. This authority shall continue in force until notice in writing shall have been given to and received by the bank. All transactions aforesaid which have taken place heretofore are hereby confirmed and ratified."

The following Resolution was thereupon unanimously adopted:—

"Resolved that The National Bank of Commerce of Seattle be and it hereby is selected as a depository for the funds of this Corporation, and that said funds shall be withdrawn from said depository

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

on the check of this Corporation, signed by any two of the following:—

W. Braicks ....President
Fred W. Wonn..........................Vice-President
J. G. Molz ....Secretary
Eleonore Pfisterer ....Treasurer

and that the authority hereby conferred shall continue in force until notice of its revocation in writing shall be given to the depository.

Be it further resolved that the said officers, or either of them, are authorized by and on behalf of the Company to borrow at said The National Bank of Commerce of Seattle, on promissory notes or other evidences of indebtedness of this Company, and to discount, endorse and negotiate acceptances, promissory notes and other negotiable paper with said Bank, and to withdraw the proceeds thereof.

Be it further resolved, that the authority hereby conferred shall include the authority to draw and/or endorse checks and other paper payable (or by said officers or either of them made payable) to the order of, or for the benefit of said officers, or either of them, or to cash, or to bearer, and to receive, jointly or severally, the payments or proceeds thereof."

(Testimony of J. G. Molz.)

Plaintiff's Exhibit No. 6—(Continued)

There being no further business the meeting was adjourned.

W. BRAICKS,
President.

J. G. MOLZ,
Secretary.

Q. I notice that that liquidating resolution was dated September 30, 1937, and that the Minutes of the new [68] company show a first meeting of stockholders on September 25, 1937?

A. Yes.

Q. Do you know the occasion for the organization steps being taken in the new company prior to the dissolution of the old?

A. All of our business is governed by the Internal Revenue Department in consultation, at the place; as soon as we were sure of the wishes of our stockholders and we contacted the officer in charge of the Alcohol Tax Unit in Seattle, who told us at no time——

Mr. Winter (Interrupting): I object to what someone told him as not binding on the United States.

Mr. Jones: I think it is true, not binding, but I am asking him to explain the difference in dates of the two companies, I think without trying to bind anybody, what this other man said—that is not the

(Testimony of J. G. Molz.)

purpose at all, merely to afford an explanation why they——

The Court (Interrupting): With reference to their right to make wine with the alcohol tax?

Mr. Jones: It doesn't involve the tax question at all.

The Court: I will overrule the objection.

Mr. Winter: I couldn't anticipate what the witness is going to say.

A. Our premises, are bonded premises and in order to continue or protect our type or any type of operation, it was necessary to disclose to the Alcohol Tax Unit steps which might be taken in order to protect the license and in order to protect the property of the United States, [69] as far as tax collection is concerned; that is why it was necessary to apply for a license for the new company, even previous to liquidating the old.

Q. Do you recall what action, if any, was taken with reference to advising shareholders as to amounts to be reported by them upon the liquidation of the old company?

Mr. Winter: We object to that as irrelevant and immaterial, if the Court please, what they advised the stockholders to do, after the organization.

Mr. Jones: I think it is quite important to show one of the theories we go on is the stockholders were advised to report and did report the income from this transaction accruing to them as taxable income.

(Testimony of J. G. Molz.)

The Court: You already proved that this morning with the two letters of Mr. Buschmann.

Mr. Jones: I proved as to Mr. Buschmann, not all the stockholders.

The Court: I will overrule the objection.

Q. You can state, briefly, what you did about that, what you individually and as Secretary of the Company?

A. Similar letters were sent to all the stockholders, notifying them of the complete assets of the liquidated company and showing them their proportionate share of these liquid assets.

Q. Did you file an income tax return, yourself, for 1937? A. I did.

Q. And did you return the amount of your income from this liquidation in your income tax return? A. I did.

Mr. Jones: Do you have his income tax return, [70] Mr. Winter, or a copy of it? If you find it later, we can submit it. We have his testimony here.

Mr. Winter: I don't see it.

Q. Was there a sheet like that, attached to the deposition, wasn't there, Your Honor, in connection with Mr. Buschmann's testimony? (Indicating)

The Court: No.

Mr. Jones: He referred to a statement or analysis——

The Court: No, this is what was attached? (Indicating)

(Testimony of J. G. Molz.)

Mr. Jones: Yes.

Q. I will show you what is marked "Analysis of individual profits on dissolution distribution" and ask you if you can identify that paper?

A. Yes, I can.

Q. What is it?

A. It is an analysis of individual profits on dissolution distribution, dated October 4, 1937.

Q. Who prepared it?

A. It was prepared by Harold Scott.

Q. And was anything done with that with reference to the individual stockholders?

A. Each stockholder was notified of his proportionate share in the company.

Q. As shown on that statement?

A. That is correct.

Mr. Jones: I will ask to have this marked as plaintiffs' exhibit 7. Then I will have Mr. Scott identify it further as to what was done. (Handing [71] document to Mr. Winter.)

You have seen it, Mr. Winter.

That is all, Mr. Molz.

Cross Examination

By Mr. Winter:

Q. How long did you say you have been with the Pommerelle Company, Inc. or its predecessor?

A. Since 1934, September 15th, if I remember correctly.

Q. You have increased the capitalization of the

(Testimony of J. G. Molz.)

old company without reorganization prior, didn't you? A. That is entirely possible.

Q. Well, isn't it a fact, don't you recall, the capital was increased of your company while you were Secretary without liquidation?

A. That is right.

Q. Then the purpose of your liquidation was to get higher valuation capital stock, wasn't it?

A. Partly.

Q. Wasn't that, solely, the reason?

A. We wanted that—we wanted to increase our capital value——

Q. (Interrupting) You could have increased your capital value without capitalization or reorganization? A. Yes.

Q. And you so understood?

A. We discussed this matter very carefully before.

Q. A long time before that? A. Yes.

Q. It was understood between you and the officers, you would handle it in this manner to get a higher capitalization? [72]

A. Yes.

Q. And, as a matter of fact, you organized the new corporation in September 25th, 1937? and held your first meeting? A. That is right.

Q. And it was intended that the corporation would carry right on the wine that was in the process of manufacture at that time?

A. I explained to you a few minutes ago, we had the Alcohol Tax Unit——

(Testimony of J. G. Molz.)

Q. (Interrupting) You had wine in the process of manufacture? A. Yes.

Q. And there wasn't—you went right on with your deliveries and sales on the day of the——?

A. (Interrupting) That is right.

Q. Now, you say, when you carried out—I think you stated that you carried out, pursuant to the resolution, you carried out the provisions of the resolution of September 30th, 1937—what did you mean by that statement, that you carried it out?

A. We were fully aware, individually, that we had to face quite a stiff income tax problem, ourselves, as stockholders and we were fully prepared to meet that obligation and pay it. Our stockholders knew, in the event the company was to be liquidated, they, themselves, had to dig into their pockets and pay it.

Q. When you say "carried out the provision of that", you were thinking of your own income liability? A. Definitely.

Q. What did you do with respect to the title to real estate, or contracts for real estate? [73]

A. As far as we knew, that was all transferred at the time, it had to be done.

Q. It wasn't transferred until 1939?

A. All transferred, as far as I knew; unfortunately, possibly one of our lawyers made a mistake, I don't remember.

Q. Did you execute or make any assignment of a real estate contract at that time?

(Testimony of J. G. Molz.)

A. I, personally, am not an attorney.

Q. I am asking if you did, as liquidating trustee?

A. Yes, I tried to do everything I possibly could.

Q. Don't you know, as a matter of fact, it wasn't until 1939 you made an assignment of the contract to purchase real estate? A. I don't know.

Q. That the company owned?

A. I haven't any idea of that particular transaction.

Q. Don't your records show, can't you tell the Court what instruments you executed at that time?

A. The statement to the company was made October 4th.

Q. You didn't execute a bill of sale to the new company? A. Everything——

Q. (Interrupting) Did you?

A. Everything was included——

Q. (Interrupting) I say, you didn't, did you?

A. Bill of sale?

Q. Yes? A. No.

Q. Nor did you give any deeds to property?

A. We didn't have property. [74]

Q. You didn't contract to purchase property?

A. Yes.

Q. You didn't make any assignment at that time?

A. No, sir.

Q. And all you say you did was to think about your income tax liability, that was carrying out the provision—you understood it was agreed the company would continue to run, continue to operate

(Testimony of J. G. Molz.)

with the wine in process just the same as before, wasn't it?

A. Naturally, we had to keep this company going because it was our bread and butter.

Q. How much did you offer to pay for the stock, to the individuals?

A. Well, it was agreed, divided according to our absolute assets, this list of assets, as was computed by our accountant and the list was divided into the stock outstanding at the time that happened.

Q. All liability transferred to the new corporation?

A. Were to be paid out of those assets, out of the old corporation before liquidation — so much left.

Q. It was intended to transfer those liabilities to the new corporation?

A. I wouldn't say, transfer the assets, what was left over.

Q. Did they take over the assets?

A. As far as I am concerned; I really don't remember the technical aspects but the company was absolutely dissolved at the time, there wasn't anything left.

Q. I didn't ask you what the effect was, I am asking what you transferred. Didn't you transfer the assets to the new corporation?

A. No, we sold everything we had at the time. [75]

Q. Who did you sell it to?

A. Well, it was offered for sale.

(Testimony of J. G. Molz.)

Q. Who did you offer it for sale?

A. Naturally, to the people who happened to be at this meeting and if they were agreeable to buying, fine, if not someone else would have bought.

Q. I thought you said you offered to purchase their stock?

A. No, if they had wanted to sell, I would have been most happy to——

Q. (Interrupting) Buy their stock?

A. Definitely.

Q. Who first proposed this liquidation reorganization, your accountant, Mr. Scott?

A. We sat together several times; we had our regular monthly meetings and in these meetings discussed various problems facing us and, as I mentioned before, we were growing so rapidly and our Company was in such a difficult position that it was necessary for us to do something and this was the plan we adopted.

Q. Well, you had, also, had a growth previous, your company had had a very marked growth previous to that time? A. That is correct.

Q. And you had increased the capitalization one or two times before? A. Yes.

Q. What was the capitalization at the time of the socalled liquidation?

A. If I remember right, it must have been 20,000 or 25,000 shares.

Q. Originally, 1,000 shares? [76]

(Testimony of J. G. Molz.)

A. Yes.

Q. Increased up to 20,000? A. Yes.

Q. You made no attempt to liquidate that company, you had changed the name? A. Yes.

Q. Increased the capitalization?

A. Well, in those days, of course, we had an awful tough time; we first started out losing money right along; gradually, as we got under way, we made a little bit of money but it was all put absolutely back in the business; there was just nothing left, we felt this was a legitimate way to take care of our problem.

Q. Well, the stockholders both before and after the socalled liquidation were the same, were they not? A. Yes, they happened to be the same.

Q. I say, they were the same? A. Yes.

Q. The proportion, or ratio, capital stock held by the stockholders in the old corporation was identical with that held in the new? A. Yes.

Q. The balance of the old stock of the company was the same as that of the new company and the net worth, $60,000, was the same in both instances, was it not? A. That is right.

Q. The type and class of the stock was the same in the old and new companies, the assets and liabilities assumed by the new company were those of the old company, were they not? [77] A. Yes.

Q. No new capital was put in the corporation as the result of the reorganization, was there?

A. No.

Q. No transfer of real estate was ever made to

(Testimony of J. G. Molz.)

the shareholders and title to the personal property, was ever transferred to the shareholders, was it?

A. You mean, trucks——?

Q. Did you execute any bills of sale to personal or real property, to the shareholders?

A. Not that I know of.

Mr. Winter: I think that is all.

Redirect Examination

By Mr. Jones:

Q. Did the Company own any real estate to which it had title at that time?

A. No, only had this contract, if I remember, at that time we were purchasing a hotel on Dearborn Street.

Q. And what was done about the contract?

A. I really could not tell you, I feel reasonably certain everything was attended to, I couldn't tell you, I haven't the slightest idea; I didn't take care of the real estate proposition.

Q. Now, I asked you if you filed a personal income tax return in which you included your determined share of the property as income? Have you ever filed any claim for refund of tax on account of that transaction?

Mr. Winter: I object to that as incompetent, [78] irrelevant and immaterial, in this case.

Mr. Jones: That is probably true, yet it might be of some significance to show that the Commissioner has never refunded to the shareholders, he is

(Testimony of J. G. Molz.)
still retaining the tax they paid on the theory this was a taxable transaction.

Mr. Winter: I don't think that, necessarily, follows. It seems to me there is nothing in the law which would require the Commissioner, certainly, taking the position it was non taxable dividends.

The Court: I won't admit it on that basis, Mr. Jones, I admitted part of the testimony, the testimony with reference to Mr. Buschmann this morning, on this theory, I don't know whether it is coming into this case at all, the question of good faith or bad faith in the transaction; now you say, very frankly, in your statement one of the purposes of this was to solve their tax problem. Now, some people attempt to solve their tax problems by doing it —by means of subterfuges, things of that kind, I don't know whether that is an element in this case, but I will admit the testimony on that possible theory, that it might tend to negative that, if that inference is drawn from the fact the transaction was put through.

Q. I think you did testify that you did include that, you say you never filed a claim for refund of tax to yourself?

A. Well, I filed—I didn't file it, I signed a statement at the time.

Q. Have you received any refund of that tax?

A. No, I have not. [79]

Mr. Jones: That is all.

(Witness excused)

HAROLD L. SCOTT,

called as a witness on behalf of the plaintiffs herein, being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. State your name? A. Harold L. Scott.

Q. Your business?

A. Certified Public Accountant.

Q. Where do you carry on that business?

A. In Seattle.

Q. How long have you been practicing that profession? A. About 23 years.

Q. What has been your connection with the Pommerelle Company, the old and new companies?

A. We were employed as accountants for the old company and new company.

Q. Do you recall the occasions that have been testified to, about liquidating the old corporation and organizing the new corporation?

A. Yes, I do.

Q. What, if anything, did you have to do with that?

A. I was called by the company's officials in the summer of 1937 relative to their problems, they wanted to know what could be done to work them out and we made the examination to determine what should be done and what [80] would be the best thing to do, and made recommendations accordingly.

Q. Now, there is involved in this case an item of $75.00 paid to a Mr. Bordson during the year

(Testimony of Harold L. Scott.)

1937, which has been disallowed by the Commissioner, do you know what that item represented?

A. As I recall it, that represented—

Mr. Winter: (Interrupting) If it is taken from the books and records (if he knows of his own knowledge, we have no objection) but if it is taken from the books and records, the books and records are the best evidence.

Mr. Jones: Your 90-day letter states, fee for increasing capital stock, 1937.

Mr. Winter: In your protest, the basis of this suit, I quote—

Mr. Jones: (Interrupting) Let it go. The 90-day letter will speak for itself anyhow, showing what the nature of it was.

Q. Now, did you have an item of either $600.00 or $685.00 to your Company, Mr. Scott?

A. Yes, $600.00.

Q. What was that for?

A. $450.00 approximately—it wasn't segregated—the account was rendered as one item—$450.00 approximately would be the cost of preparing the income tax returns and preparing the statements of the company.

Q. During what period?

A. During the period January 1st to October 4th, 1937, and $150.00 in connection with the dissolution of the company. [81]

Q. And was that amount, $600.00, paid to you by the company? A. Yes.

(Testimony of Harold L. Scott.)

Q. Now, with reference to the matter of dissolution of the old company, you said that you were consulted with reference to certain problems of the company, what were the problems you had in mind?

A. Well, the company had a low declared value for capital tax purposes, at the time the declaration was made the company was small and it had had a very sudden growth; the earnings——

The Court: (Interrupting) Non par stock?

Mr. Jones: No, $1.00 stock.

The Court: To get it in the record.

A. $1.00 par value. Their earnings had been increasing year by year and they had declared their capital stock value at, I believe, to be $100,000.00 and that, therefore, gave them an exemption $10,000.00 excess profit taxes; their earnings for 1937 were increasing and were far in excess of that and they asked my suggestions as to what I felt should be done and I made an investigation to see what recommendation should be made and came to the conclusion that the best way to handle the matter would be to liquidate the corporation and if they, all of the stockholders, wanted to go on with the new corporation, they could or any part of them wanted to withdraw, but insisted they be given that right,—there must be a complete liquidation of the old company and if they wanted to subscribe and put in their assets, their undivided portion of those assets into the new corporation, [82]

(Testimony of Harold L. Scott.)

that they must have that right or they could sell them or take them or do anything they saw fit with them.

Q. Do you know whether there was any discussion of these matters you have just testified to between you and the other stockholders, among the stockholders, themselves?

A. Yes, there was.

Q. Tell us what you know about that, to what extent it was discussed among the stockholders?

A. I believe I was at two meetings of the company; I remember one very definitely, where just before the liquidation was entered into, I went into it very much in detail. There was the one question as to whether or not this liquidation should be made to be a taxable transaction or non taxable transaction. I wrote Prentice Hall and Commerce Clearing House relative to it and I believe in the Commerce Clearing House rewrite service, there was quite a discussion of the matter and they held that——

Mr. Winter: (Interrupting) We object to what the Commerce Clearing House says.

Q. You can't state that.

A. I discussed with the group of the stockholders as to whether it should be tried to be made a non taxable reorganization or a taxable reorganization and I recommended that they should follow a taxable reorganization, due to the fact that there was a question in my mind as to whether it could

(Testimony of Harold L. Scott.)

be held to be non taxable. In other words, that they could actually prove a non taxable reorganization, and have the right to get their increased declared value on the new corporation. [83]

Q. What—? go ahead. I thought you were through.

A. And then I carefully explained to each one of the stockholders that were present at this meeting, and I believe the larger stockholders were all there, that they would have to pay the tax on their proportionate share, as a liquidation over and above their original cost and I am sure that there was no question as to what that was clearly understood by those present and I prepared a statement later and gave it to the company's officials, which was forwarded later to the stockholders, showing their proportionate amount.

Q. Is this plaintiffs' 7 (8) for identification, the statement to which you refer?

A. Yes, it is; yes, this is the statement we prepared in our office, one of the carbon copies.

Mr. Jones: I offer it in evidence.

Cross Examination

By Mr. Winter:

Q. I take it, this is an analysis of the books of the Pommerelle Company, Inc., your analysis of the books of the Pommerelle Company, Inc., is that right?

A. No, I don't take the analysis of the company's books at all. I take it as of the date of the

(Testimony of Harold L. Scott.)
purchase of shares by each stockholder, as shown by the——

Q. (Interrupting) Books?

A. Stock records of the company and showing the number of shares purchased, the date purchased, the cost at par.

Q. As shown by their books? [84]

A. I wouldn't say yes, I don't think there have been any transfers of this stock, except stock that was purchased from the company. I can't answer that question, Mr. Winter, for this reason——

Q. (Interrupting) You made the exhibit, didn't you?

A. It shows the cost at par and I am sure that that is the cost to each one of these stockholders.

Q. Well, it is an analysis of the information taken from the books of the Pommerelle Company, Inc., isn't it?

A. When you say "books", that is the part I am questioning.

Q. "Records" of the Company, then?

A. Yes, from the records—I guess I can answer it yes.

Q. Books and records?

A. Yes, then distribution, October 4, 1937, amount distributable to each man on each purchase of his stock. In other words, dividing it between the dates of purchase because he had different rates of pay the tax at and the time held and percent of profit to report and net profit he should include in his taxes.

(Testimony of Harold L. Scott.)

Q. Values thereon are book values, as shown by the books of the company, is that right?

A. Yes.

Q. You made no attempt to valuation on the assets, anything of that nature, except what the books showed, is that right?

A. Well, the books would show the value of the inventory at the date of the dissolution.

Q. I say, it was book values as shown in the books of the company? A. That is right. [85]

Q. You made no independent investigation or no attempt to set any values, other than shown in the books? A. I think——

Q. (Interrupting) Personally, I mean?

A. That was analyzed——

Q. (Interrupting) I said "You", Mr. Scott. You understood my question.

A. I understand your questions. In any liquidation, a person——

Q. (Interrupting) That is not responsive. Did you make a personal investigation as to the value of assets? A. I am not a valuation engineer.

Q. I didn't ask you if you were a valuation engineer, Mr. Scott, did you make any investigation? A. Yes, there was some investigation.

Q. You did, personally? A. Yes.

Q. You attempted to value some assets?

A. Certificates were carefully analyzed to see what were good and bad, surely.

(Testimony of Harold L. Scott.)

Q. Any physical assets other than intangibles?

A. The question was to determine the cost of the wine—I made a very careful examination to determine that.

Q. Other than was shown on the books of the company?

A. We gave them the figures to put on the books.

Q. At that time? A. Yes.

Q. Then you arrive at your——?

A. (Interrupting) Closing entries were given to the company by ourselves. [86]

Q. You arrive here, the last figure, what you consider the net profit to report?

A. That is correct.

Q. And that is your conclusion as an accountant for the company? A. That is right.

Mr. Winter: We have no objection for what it is worth, if the Court please, an analysis of an accountant.

The Court: It may be admitted. ?

The Clerk: Plaintiffs' exhibit No. 7.

Plaintiffs' Exhibit No. 7, the statement last above referred to, admitted in evidence.

PLAINTIFF'S EXHIBIT No. 7

POMMERELLE COMPANY, INC.

ANALYSIS OF INDIVIDUAL PROFITS ON DISSOLUTION DISTRIBUTION

October 4, 1937

Page 1

	No. of Shares Purchases	Total	Date Purchased	Cost at Par	Distribution October 4, 1937 2.4087603	Total	Profit	Total	Time Held	Per Cent of Profit to Report	Net Profit to Report	
A. Vanderspeck	225		2- 3-34	$ 225.00	$ 541.97		$ 316.97		2 to 5 Years	60	$ 190.18	
	1,775		9- 1-34	1,775.00	4,275.55		2,500.55		2 to 5 Years	60	1,500.33	
	1,000		6-10-35	1,000.00	2,408.76		1,408.76		2 to 5 Years	60	845.26	
	2,100	5,100	12-14-36	2,100.00	5,058.40	12,284.68	2,958.40	7,184.68	Under 1 Year	100	2,958.40	$ 5,494.17
W. Braicks	225		2- 3-34	225.00	541.97		316.97		2 to 5 Years	60	190.18	
	1,275		9- 1-34	1,275.00	3,071.17		1,796.17		2 to 5 Years	60	1,077.70	
	1,000		6-10-35	1,000.00	2,408.76		1,408.76		2 to 5 Years	60	845.26	
	1,750	4,250	12-14-36	1,750.00	4,215.33	10,237.23	2,465.33	5,987.23	Under 1 Year	100	2,465.33	4,578.47
J. G. Molz..................	200		2- 3-34	200.00	481.76		281.76		2 to 5 Years	60	169.06	
	1,950		11-27-36	1,950.00	4,697.08		2,747.08		Under 1 Year	100	2,747.08	
	1,505	3,655	12-14-36	1,505.00	3,625.18	8,804.02	2,120.18	5,149.02	Under 1 year	100	2,120.18	5,036.32
Eleonore Pfisterer....	1,500		10-17-35	1,500.00	3,613.14		2,113.14		1 to 2 years	80	1,690.51	
	250		11-27-36	250.00	602.19		352.19		Under 1 Year	100	352.19	
	1,225	2,975	12-14-36	1,225.00	2,950.72	7,166.05	1,725.72	4,191.05	Under 1 Year	100	1,725.72	3,768.42
August Buschmann..	1,000		10-21-35	1,000.00	2,408.76		1,408.76		1 to 2 years	80	1,127.01	
	500		6-10-35	500.00	1,204.38		704.38		2 to 5 Years	60	422.63	
	1,050	2,550	12-14-36	1,050.00	2,529.20	6,142.34	1,479.20	3,592.34	Under 1 Year	100	1,479.20	3,028.84
Fred W. Wonn........	225		2- 3-34	225.00	541.97		316.97		2 to 5 Years	60	190.18	
	775		9- 1-34	775.00	1,866.79		1,091.79		2 to 5 Years	60	655.07	
	700	1,700	12-14-36	700.00	1,686.13	4,094.89	986.13	2,394.89	Under 1 Year	100	986.13	1,831.38
Gilbert Kroll	500		11-27-36	500.00	1,204.38		704.38		Under 1 Year	100	704.38	
	350	850	12-14-36	350.00	843.07	2,047.45	493.07	1,197.45	Under 1 Year	100	493.07	1,197.45
J. Kangley	500		11-27-36	500.00	1,204.38		704.38		Under 1 Year	100	704.38	
	350	850	12-14-36	350.00	843.07	2,047.45	493.07	1,197.45	Under 1 Year	100	493.07	1,197.45
C. S. Leede................	250		11-27-36	250.00	602.19		352.19		Under 1 Year	100	352.19	
	175	425	12-14-36	175.00	421.53	1,023.72	246.53	598.72	Under 1 Year	100	246.53	598.72
Wm. E. Leede..........	500		6-10-35	500.00	1,204.38		704.38		2 to 5 Years	60	422.63	
	350	850	12-14-36	350.00	843.07	2,047.45	493.07	1,197.45	Under 1 Year	100	493.07	915.70
Dorothy Leede	500		6-10-35	500.00	1,204.38		704.38		2 to 5 Years	60	422.63	
	350	850	12-14-36	350.00	843.07	2,047.45	493.07	1,197.45	Under 1 Year	100	493.07	915.70
												Page 2
Eleonore M. Leede..	500		6-10-35	500.00	1,204.38		704.38		2 to 5 Years	60	422.63	
	350	850	12-14-36	350.00	843.07	2,047.45	493.07	1,197.45	Under 1 Year	100	493.07	915.70
E. A. Hulitz..............	350		6-10-35	350.00	843.07		493.07		2 to 5 Years	60	295.84	
	245	595	12-14-36	245.00	590.14	1,433.21	345.14	838.21	Under 1 Year	100	345.14	640.98
		25,500		$25,500.00		$61,423.39		$35,923.39				$30,119.30

(Testimony of Harold L. Scott.)

Direct Examination
(Continued)

By Mr. Jones:

Q. Mr. Scott, you said in previous answers to my questions that there was discussion between you and the stockholders and amongst the stockholders, themselves, about stockholders of the old company coming into the new [87] company or not. I would like to have you tell us a little bit more what that discussion was and what individual stockholders you recall having participated in it?

A. Well, I was asked the question as to whether or not all stockholders had to come in——

Mr. Winter: (Interrupting) We insist on the time, place and dates, if he is going to tell a conversation with certain individuals.

The Court: I will sustain the objection.

He asked you the question which stockholders you talked to. You can answer that question?

A. Yes, Mr. Braicks, Mr. Molz, Dr. Leede, Mr. Vanderspek, Mr. Buschmann, Mr. Wonn, Mrs. Pfisterer I believe was there.

Q. About when did these conversations occur?

A. Oh, somewhere in September 1937.

Q. And what was the substance of them?

A. As to whether or not all of the stockholders were compelled to come in and subscribe to the stock of the new corporation or if they wanted to

(Testimony of Harold L. Scott.)

withdraw and take their share of the assets, and I said if they dissolved the old corporation, they would be entitled to take their share and do as they saw fit with them and—that is the answer to it.

Q. Was there any discussion as to what would be done in case any stockholder didn't want to go in the new corporation? A. Yes, there was.

Q. What was that? [88]

Mr. Braicks and Mr. Vanderspek, Mr. Molz, Mr. Buschmann said that they—if any stockholder didn't want to go ahead and turn his share of the assets that they received from the liquidation into the new corporation, that they would get together and buy up that share.

Q. Are you, personally, familiar with whether any arrangements were made with any bank for accomplishing that?

A. Yes, I was familiar with it; it is pretty hard, maybe, for me to testify to it.

Q. All right. I won't ask you further.

A. I know what took place but I don't believe I can testify to it.

Q. Did you represent Mr. Vanderspek, one of the stockholders of this Company? A. Yes.

Q. In connection with these tax matters?

A. Yes, I did.

Q. Mr. Vanderspek, I believe, is ill and couldn't come over here to testify?

A. Yes, he has been sick for sometime.

(Testimony of Harold L. Scott.)

Q. You hold his power of attorney, as of 1937?

A. Power of attorney filed in the Agent's office in my favor.

Mr. Jones: Do you have Mr. Vanderspek's return, Mr. Winter? You had the copy when you took his deposition?

Mr. Winter: Yes.

I don't know if I am privileged to disclose Mr. Vanderspek's income tax return, if the Court please. Mr. Vanderspek is not here and certainly has [89] not filed a power of attorney of Mr. Scott with me to the effect—I have never seen it.

Mr. Jones: Mr. Winter, when we took the depositions, it is my recollection you said you had Mr. Vanderspek's return.

Mr. Winter: I have Mr. Vanderspek's return.

Mr. Jones: (Continuing) And Mr. Scott had the power of attorney and on his say-so, may be inspected.

Mr. Winter: Now that you call my attention, I think I have Mr. Vanderspek's—I don't want to divulge any information here——

Mr. Jones: (Interrupting) That is my understanding; if not, we can get his report.

Mr. Winter: I didn't have his power of attorney.

Mr. Jones: I think you have.

Mr. Winter: No, Mr. Braicks' and Mr. Molz' is the only thing I had——

Mr. Jones: (Interrupting) May I ask this, Mr.

(Testimony of Harold L. Scott.)

Winter, if I get written authorization from Mr. Vanderspek to produce his return and file his return, will you produce it?

Mr. Winter: If the Court orders me to produce it, I will do it.

Mr. Jones: I don't want to embarrass you, if you want to produce it.

Mr. Winter: I don't have that information. May I ask Mr. Scott one question?

Mr. Jones: Yes. [90]

Mr. Winter: Did you file claim for refund on Mr. Vanderspek's income tax? A. No.

Mr. Winter: You did on——?

A. (Interrupting) Mr. Molz and Mr. Braicks.

Mr. Winter: That is the power of attorney I have, Mr. Jones; only reports, Revenue Agent's, is Braicks and Molz, we have the power of attorney on those cases.

Mr. Jones: I thought he had power of attorney for Mr. Vanderspek?

A. That is true, I have power of attorney for Mr. Vanderspek.

Mr. Jones: Is it on file with the Revenue Department?

A. In the Agent's office, Mr. Winter made that statement when my deposition was taken.

Mr. Winter: I remember in respect to one of them, Mr. Jones.

A. That is the one I think you are speaking of.

(Testimony of Harold L. Scott.)

Mr. Winter: Do you recall that was taken down?

Mr. Jones: I don't remember it being in the transcript; I do remember it in the discussion.

Mr. Winter: I didn't have his file, Mr. Jones.

Mr. Jones: If I get a letter of authority from Mr. Vanderspek to publish his return, you will produce it and permit it to be filed, will you?

Mr. Winter: I beg your pardon, Mr. Jones, I can produce it right here. Here is where we got it, Mr. Jones, attached to the return as a——

Mr. Jones: (Interrupting) I knew you had it. [91]

Mr. Winter: That is where we got it.

Mr. Jones: I offer in evidence as plaintiffs' Exhibit No. 8 photostatic copy.

The Court: How do you spell it?

Mr. Jones: V-a-n-d-e-r-s-p-e-k.

The Court: 1937?

Mr. Jones: Yes, 1937 return.

The Court Admitted.

Mr. Winter: We have no objection to a copy being produced, but we do object to it as incompetent, irrelevant and immaterial, that it has nothing to do with the issues in this case.

The Court: I will admit it with the same reservation.

Mr. Jones: That is all.

Plaintiffs' exhibit No. 8, the 1937 income tax return of Mr. Vanderspek, admitted in evidence.

(Testimony of Harold L. Scott.)

Cross Examination

By Mr. Winter:

Q. Did you prepare claim for refund for the Pommerelle Company, Inc., in this case, Mr. Scott?

A. Let me see it there. I don't believe I did. I think Mr. Jones' office prepared it. No, we didn't prepare that. (Indicating document.)

The Court: Do I understand, claim for refund for Braicks and Molz—before the part of their return—being as a result of paying tax?

Mr. Winter: Yes, they filed claim for refund. [92]

Q. You were attorney for Mr. Braicks and Mr. Molz?

A. Yes, I prepared their tax returns.

Q. You prepared their returns and also on their behalf filed claims for refund?

A. After this case, tax was paid on this case, or after the 90-day letter was issued, I filed claims, as protective claims.

Q. You did file claims for them? A. Yes.

Q. And, in the event this case is adverse to the plaintiff, of course you will proceed to——?

A. (Interrupting) I presume so, yes.

Q. (Continuing) ——work on those claims, won't you? A. Yes.

Q. Now, on the amounts, the profit which you have set forth in your analysis, that is the profit of the individual stockholder which you have set

(Testimony of Harold L. Scott.)

forth? You show, for example, a profit to J. J. Molz of $5,036.32? A. Yes.

Q. Is that income or is that a capital gain?

A. That is capital gain—liquidation.

Q. And reportable 50 percent stock held more than two years?

A. That wasn't true at that time the law changed, since then part held from two to five years, some under one year; so, $4800.00 of the $5,000.00 was reportable 100 percent.

Q. Anyway, lower than 100 percent of the profit, which you show on that exhibit?

A. Well, his actual profit as shown on the exhibit was $5149.02 and amount reportable on his tax return was $5,036.32, a difference of $113.00. [93]

Q. Who is that, Braicks? A. No, Molz.

Q. Give those figures again?

A. (Indicating on exhibit.)

Q. Molz didn't acquire the stock, most of it, until 1936, did he?

A. That is true, the majority of it acquired in 1936, latter part of 1936, held it less than one year.

Q. Mr. Vanderspek, the amount of his profit was $7,184.68 and his taxable profit on his capital gain was only $5,404.17, is that right?

A. That is correct.

Q. In none of these instances was it taxable at 100 percent gain?

A. The record shows here the profit realized

(Testimony of Harold L. Scott.)

by each and the amount reportable under the law for each one on account of the time held. (Indicating.)

Q. In no case was it 100 percent?

A. Yes, in C. S. Leede, it was 100 percent and in Kangley it was 100 percent and in Gilbert Kroll it was 100 percent.

Q. There was also only 60 percent on Dorothy Leede with respect to 500 shares, is that right?

A. That is correct.

Q. Dorothy Leede and William, 60 percent with respect to 500 shares? A. That is true.

Q. And 60 percent with respect to Wayne and 27, two 27——?

A. (Interrupting) That is correct.

Q. And various amounts? A. Yes. [94]

Q. Braicks only 60 percent on 2,495 shares?

A. 2,500 shares.

Q. 2,500 shares? A. That is correct.

Q. The exhibit shows percentage?

A. Yes, that is due to the conditions of the capital gain section.

Q. Now, Mr. Scott, the proceedings that were taken here with respect to the dissolution or reorganization, whichever you want to determine it, was your suggestion, your advice?

A. I think so.

Q. Did you have anything to do with executing any documents in connection with the actual transfer of any properties?

(Testimony of Harold L. Scott.)

A. You mean, personally?

Q. Yes?

A. No, I did not execute any documents; Mr. Bordsen was the Company's attorney at that time, he was handling that.

Q. I think you said that $450.00, approximately, of your——? what was the amount of your bill to the company? A. $600.00.

Q. You say approximately $450.00 was for auditing the returns and making income tax returns?

A. Auditing the books, making income tax returns, preparing statements of the company.

Q. How much time did it take to prepare the income tax returns after you got the audit?

A. I can't state exactly, I was just figuring the bill as nearly as I could. [95]

Q. On non taxable reorganization, the fees would have been approximately the same, would they not?

A. Well, I don't see any difference as far as taxable or non taxable reorganization.

Q. You would make no difference?

A. No, I don't think it would make any difference.

Q. Do you know what the $75.00 bill was for, you say "$75.00". A. To Mr. Bordsen?

Q. Yes, if you know?

A. No, I would rather let one of the others testify to that.

(Testimony of Harold L. Scott.)

Q. Now, in the claim for refund filed it states "a portion of the assessment was based on the disallowance, deduction of certain expenses, totalling $785.00, these were in their entirety professional services needed in winding up and liquidation of the company", is that true?

A. Where is that statement?

Q. In the claim for refund.

A. I didn't make claim for refund; I think this is the first time I ever seen it.

Q. You say you rendered your bill, you didn't make any allocation as to what portion of it was auditing and what proportion was preparing the books—I mean the returns?

A. No, I did not. I don't believe that anyone could make a definite line of any account of that type.

Q. Did you render any other bills to the Pommerelle Company, Inc. or did they pay any other moneys for [96] fees during the year 1937?

A. No, I did not.

Q. When were you first consulted by the Pommerelle Company, Inc. relative to their tax problems?

A. Oh, I would say in the year 1934, 1935.

Q. And you still represent the new company?

A. Yes.

Mr. Winter: I don't think of anything further.

Mr. Jones: That is all, Mr. Scott.

(Witness excused)

The Court: We will take a short recess.

(Short recess)

L. H. BRAICKS

called as a witness on behalf of the plaintiffs herein, being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. Will you state your name, please?

A. L. H. Braicks.

Q. You live in Seattle, Mr. Braicks?

A. Yes.

Q. Were you connected with the old Pommerelle Company? A. Yes.

Q. Are you connected with the present new Pommerelle Company? A. Yes.

Q. What was your connection with the old Company? [97] A. President.

Q. And stockholder?

A. Stockholder and President.

Q. Were you President of that Company from the time of its organization? A. Yes.

Q. And what is your connection with the present new company?

A. Still President of the Company.

Q. So that you have been President for both companies throughout their existence?

A. Yes.

Q. Now, you recall the transaction we have

(Testimony of L. H. Braicks.)

been testifying about here, considering with reference to the liquidation of the old company and formation of the new? A. Yes.

Q. What was the occasion for taking that step?

A. Well, in the first place, we had in mind to increase our capitalization and, second place, we wanted to try to get a higher declared value on our stock.

Q. And who advised you with reference to the steps to be taken?

A. We discussed it with Mr. Scott; he advised us what to do.

Q. And what did he advise you to do?

A. Liquidate the Pommerelle, Inc. and start a new corporation.

Q. Do you recall the meetings that were held at or about the time of the liquidation, meetings of the stockholders of the old company?

A. Yes.

Q. What do you recall as to any discussion or statements [98] with reference to the situation of any stockholder of the old company, who wanted to get out or stay out of the new company?

A. Well, we told the stockholders what we intended to do and told them also they were at liberty to stay out of the new corporation.

Q. What was said to them, if anything, as to their disposition of their share of the assets on liquidation, if they did not want to come into the new company?

(Testimony of L. H. Braicks.)

A. Well, some of the other stockholders would have probably bought them——

Mr. Winter: (Interrupting) We object to what they "probably" would have——

The Court: (Interrupting) Sustained.

Q. Not what you probably would have done. In substance, what was said to the stockholders?

A. We intended—

Mr. Winter: (Interrupting) Not your "intent."

Q. Not your "intent", unless it was communicated to them. In substance, what was said to them?

A. As to the new corporation?

Q. What they colud do if they didn't want to come in the new corporation, what could be done with their share of the assets?

A. They could sell their shares.

Q. Who, if anyone, was prepared to buy it?

A. I, myself, bought some in; Dr. Leede was willing to buy and some other stockholders.

Q. Was any arrangement made with the bank to handle such a purchase, if necessary? [99]

A. Yes, I went to the National Bank of Commerce and discussed it with Mr. Witherspoon and asked him if he could——

Mr. Winter: (Interrupting) I object to what he asked someone else, communicated to someone else not here.

The Court: Overruled. He is testifying as to a fact, the fact that he had a conversation, told somebody, not a question of whether that conver-

(Testimony of L. H. Braicks.)

sation was true or false—I will overrule the objection, it is not a question of cross-examining Mr. Witherspoon.

Q. What did you take up with Mr. Witherspoon?

A. I told Mr. Witherspoon what we intended to do, liquidate the old corporation, form a new corporation; possibly some of the stockholders wouldn't want to go along, wanted to dispose of their share of the assets of the old corporation and asked him, if that should happen, if more than we could handle, whether we can come to the bank and borrow money and do it; he said yes.

Q. Do you recall whether you were advised as to the amount of profit on liquidation that accrued to you, individually? A. Yes.

Q. And do you know whether or not you included that in your income tax return?

A. I beg your pardon?

Q. Did you include that in your personal income tax return?

A. Yes, I did; Mr. Scott made my return.

Mr. Jones: Do you have Mr. Braicks' return, Mr. Winter?

Mr. Winter: I don't have Mr. Braicks' return. [100]

Q. Mr. Braicks, are you willing, if your return is located,——?

Mr. Winter: (Interrupting) I don't have it.

Q. (Continuing)——to have it received——?

(Testimony of L. H. Braicks.)

Mr. Winter: (Interrupting) I might say this, his original return would be with the claim for refund, which Mr. Braicks filed. That is the reason why I couldn't get it—his original return.

Q. If your original return is located before the case is closed, are you willing to have it received in evidence in this case and made public?

A. Yes.

Q. Now, you recall that the liquidation resolution was adopted on the 30th of September 1937 and that the formation of the new company or the filing of the articles occurred some days before that, I think about September 25th, as shown by the Minute Book? A. Yes.

Q. What was the reason, do you know, for that overlap and the starting out of the new company or incorporation of it before the dissolution of the old?

A. Well, we couldn't liquidate the old corporation and go out of business before we had a new corporation, because the licenses under which we were operating were not transferable, so we had to apply for new licenses, which the Federal—for that reason, we need both companies before we could liquidate the old one.

Mr. Jones: That is all. [101]

Cross Examination

By Mr. Winter:

Q. Of course, you understood and it was al-

(Testimony of L. H. Braicks.)
ways your intent to transfer the assets of the old corporation to the new corporation, isn't that right?

A. Yes.

Q. You never intended to put them on the market and sell them to anyone else?

A. No, we distributed them to the stockholders.

Q. You didn't intend to sell the assets? You didn't offer them for sale, you didn't want to sell them? A. We didn't know.

Q. You didn't distribute the assets as such to the individuals other than to purchase their interest? A. Yes, we would have purchased.

Q. Purchased their stock? A. Yes.

Q. Would you have purchased their stock the day before?

A. No, we didn't intend to buy their stock; we intended to buy their share of the assets.

Q. According to the figures Mr. Scott made up for you? A. Yes.

Q. You didn't intend to transfer the title to the property to the individuals, did you?

A. Well, if it had been necessary, yes.

Q. I say, you didn't intend to, at that time you didn't? A. No, sir.

Q. You didn't make any assignment of the contract to the new company?

A. You mean, the real estate contract?

Q. Yes? [102]

A. No, it was forgotten.

Q. You forgot that?

(Testimony of L. H. Braicks.)

A. Our attorney forgot it.

Q. Did you forget anything else in this plan to organize a new corporation?

A. No, I don't think we did.

Q. Your sole purpose was to get a higher capitalization for income tax purposes?

A. In the meantime, increase our capital.

Q. You knew you could increase your capital without reorganizing?

A. Yes—the laws change so often.

Q. You had increased your capital before various times and hadn't reorganized?

A. No, but tax laws were different.

Q. Was it your understanding that the tax law had anything to do with the increase of the capitalization under the State Statute, was that your understanding?

A. No, we weren't sure, under reorganization, declared new value.

Q. You weren't sure upon reorganization?

A. No.

Q. If you could have reorganized and gotten an increase in capitalization, that is the way you would have handled it? A. We might.

Q. You intended to do that?

A. I don't know.

Q. You didn't change the corporate setup a bit except to increase the capitalization, did you? [103]

A. Yes, that was the main purpose, yes.

Q. You went on with the same books, you took

(Testimony of L. H. Braicks.)

over the liabilities of the old corporation and you also assumed the liabilities and took over the assets?

A. Yes.

Q. Went right on operating?

A. Didn't "assume"—we distributed them among the stockholders and they were paid with their assets.

Q. Other than the preparation of this analysis and reporting on your income tax return, what did you do in this reorganization? You discussed it?

A. Yes, discussed and instructed our accountant to figure out what our net worth was; told our attorneys to go ahead and make out the necessary papers. That is all we could do.

Q. Did you get new books for the new corporation?

A. I don't remember whether we set up—yes, we must have set up an entirely new set of books.

Q. The procedure you adopted here was entirely upon the advice of your tax consultant, is that right?

A. Yes, we put our problems before him; that is what he advised us to do.

Mr. Winter: That is all, I think.

Redirect Examination

By Mr. Jones:

Q. Mr. Braicks, Counsel asked you if you intended to have the assets of the old company go to the new company. I don't remember exactly

(Testimony of L. H. Braicks.)

what your answer was. What was your intent with respect to the transfer of the assets [104] the old company, to whom did you understand they were going to go? A. The assets?

Q. Yes?

A. To the stockholders of the old corporation.

Q. Did you understand that there was any direct relation between the old company and the new company, except as it went through the stockholders, who might in turn pay for their stock by turning in the assets?

Mr. Winter: I object to that as leading, if the Court please, not proper redirect examination.

The Court: It is leading, Mr. Jones.

Mr. Jones: It probably is leading, but I am trying to get at what Counsel asked him.

Q. I will ask you this: how did you understand that the new company was going to get the assets of the old company, if it did get them?

A. Well, the stockholders subscribed for a certain amount of shares and paid for these shares by assigning or turning over their share of the assets to this new corporation.

Q. And, where had they gotten the assets, according to your understanding?

A. When told what their share was.

Q. From what?

A. From the statements Mr. Scott made up.

Q. But, from what source did they get those assets, as you understood?

A. You mean——?

(Testimony of L. H. Braicks.)

Q. How did the assets go to them? [105]

A. I don't quite understand what you mean?

Q. Well, you say the stockholders got the assets, from what source did they get the assets?

A. We told them how much each share was.

Q. I don't mean exactly, where did they get the information what the assets were, whose assets was it that the stockholders were getting?

A. Of the old Pommerelle, Inc.

Mr. Jones: I think that is all.

Recross Examination

By Mr. Winter:

Q. May I ask—? You filed claim for refund for the tax you reported? A. Yes.

Mr. Winter: I think that is all.

(Witness excused.)

Mr. Jones: I want to call Mr. Molz back for one question.

J. G. MOLZ,

recalled.

Direct Examination

By Mr. Jones:

Q. I may be a little confused in my understanding of your testimony, as I recall I asked you if you recalled any discussion between the stockholders at about the time of the dissolution, with reference to what would be done as to the share of any stockholder who did not [106] want to go in the

(Testimony of J. G. Molz.)

new company and I thought you said that you didn't recall any such discussion. Was I right or wrong in that understanding?

A. I don't remember making that statement, Mr. Jones.

Q. Did you intend to make that statement in answer to that question?

A. No, I did not; we, naturally, had a number of discussions at the time, plenty of them, it was a very serious matter, our entire future at stake, and of course, we were concerned what would happen in the future; it was quite apparent, all of us were more or less interested in saving whatever we had and we had accomplished during that time and naturally——

Mr. Winter (Interrupting): This is all a conclusion of this witness. We want the facts.

Q. What was the purport of the discussions, with respect to what would be done as to any stockholder who might want to stay out of the new company?

A. Well, he would have an opportunity to sell his old.

Q. Do you remember what individuals expressed the willingness and ability to take over any such holdings?

A. I remember Mr. Buschmann, Mr. Vanderspek and Mr. Braicks and I, personally too.

Mr. Jones: That is all.

Mr. Winter: That is all.

(Witness excused.) [107]

Mr. Jones: I presume we can now take up the depositions?

Mr. Winter: If Your Honor desires we read the depositions to Your Honor? I suggested to Counsel Your Honor could probably read the depositions.

The Court: What about any objections to the questions?

Mr. Winter: Just as to the materiality.

Mr. Jones: That will be perfectly agreeable to me. You will get them just as well from reading them and they are very largely cumulative of the testimony that has already been offered.

The Court: Suppose I take a 10-minute recess and read them?

Mr. Winter: I think Your Honor will probably hear them better.

Mr. Jones: There is a correction on one witness's testimony. Is that incorporated in there?

Mr. Winter: We do object to that purported correction. I am advised by the Reporter that the deposition in its original form, as shown by his notes, is the original deposition. The correction appears to have been made yesterday or signed yesterday and not in my presence or did I have an opportunity to cross-examine him, as we did on the deposition.

Mr. Jones: I think you will find that strictly in accordance with the Statute. Mr. Greb spoke to me about it, said the witness refused to sign the deposition, originally as he gave it. I don't think,

until this correction is made—[108] Mr. Greb dictated the correction at the time he signed it.

Mr. Winter: Signed the original at the time Mr. Greb dictated this. We understood he would come in later.

Mr. Jones: I understand he signed it only on making the explanatory statement. Mr. Greb spoke to me about it and we got out the rule and the rule says, as I recall. I think it is Rule 34, that the testimony shall be signed by a witness and if he wants to make any explanation or change in his testimony, he shall advise the reporter of how he thinks it should be and the reporter shall take down the explanation, and up to that time the witness had refused to sign the statement because he said it wasn't what he intended and I told Mr. Greb——

Mr. Winter (Interrupting): That is not a correction within the rule. He admits—signed the deposition—what he testified, that is what we want, not what he later may have intended and wants to correct his deposition.

The Court: If I understand Mr. Jones' statement, it was not correctly reported, and he signed the deposition contingent upon the fact that the correction would be made. Is that correct?

Mr. Greb: (The Reporter who took the deposition) Yes.

Mr. Winter: If the Court please, I call Your Honor's attention to the proposed correction, reason for making the correction "the reason for mak-

ing the correction, I was confused and misunderstood, the [109] questions. He doesn't deny he so testified.

Mr. Jones: I understand the Reporter's notes were correct but the witness said that wasn't what he intended to say. I wasn't there when this was done. I told Mr. Greb what the Rule was, told him to go ahead and work it out with the witness, Huletz.

The Court: Does he live in Seattle?

Mr. Jones: Yes, he lives in Seattle. Page 37.

The Court: I have it here.

I will admit it with the understanding if you want the right of cross-examination——

Mr. Winter: This is new testimony—no right to cross-examine him.

The Court: If you want the right to cross-examine him, you will be given that right.

Mr. Winter: I would like to leave it this way if the Court please—I may or may not. I don't think that the case is going to fall or rise on this point. I don't like to ask to hold up the case but it seems to me——

The Court (Interrupting): I will tell you after I read it if I think it is important; if I tell you I am not considering it of any importance, you don't need to take further deposition; if I consider it important, you can cross-examine him further.

Mr. Winter: We recognize that the witness did give some damaging testimony, as far as the plaintiff is concerned.

The Court: We will take a recess, subject to call.

(Recess.) [110]

The following depositions were submitted to the Court:

Mr. Jones: Dr. Leede, will you be sworn?

C. S. LEEDE,

called as a witness on behalf of the plaintiffs, being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. Will you state your name, please?

A. C. S. Leede.

Q. You reside here in Seattle, do you not, Dr. Leede? A. Yes.

Q. Were you a stockholder in the Pommerelle Company, Inc., in 1937? A. Yes, I was.

Q. I believe that there were three other parties by your same family name, William E. Leede, Dorothy Leede and Eleanore M. Leede, who were also stockholders? A. Yes.

Q. Who were those several persons?

A. They are my children.

Q. And who represented them, if anyone except themselves, in matters relating to the Pommerelle Company?

A. I was their representative.

(Deposition of C. S. Leede.)

Q. Were they living here during 1937?

A. No. The boy was in Wisconsin, Madison, Wisconsin; and [111] the girl was in Chicago.

Q. Well, when you say "the boy", that would be William E., I assume? A. Yes.

Q. And the girl would be Dorothy?

A. The oldest girl, Dorothy.

Q. And was Eleanore M. a daughter too?

A. Yes.

Q. Where was she?

A. She was here in Seattle.

Q. Where are those several individuals now?

A. Well, the boy is in Springfield, Missouri; and the oldest daughter is in Houston, Texas; and the youngest is still home.

Q. Did any of those several children personally participate in meetings, or affairs, of the Pommerelle Company in 1937, or did you represent them entirely?

A. Well, I can't say that. If they were not in the city, they didn't. When they were in the city, they occasionally did go down; but as a rule, they paid no attention to it, because they knew none of the affairs. I was their representative.

Q. I call your attention to the call and waiver of notice that I submitted to Mr. Buschmann, and ask you if that is your signature on that, Dr. Leede?

A. Yes, that is my handwriting for all of them.

Q. And the signatures of Eleanore, Dorothy and William appear there also?

(Deposition of C. S. Leede.)

A. All my handwriting.

Q. That is in your handwriting? [112]

A. Yes.

Q. Did they attend that meeting? A. No.

Q. And did you represent their interests there at the meeting? A. Yes.

Q. Now, do you recall this meeting, and generally what was the subject of discussion at that meeting?

A. Yes, I recall. They were to dissolve the company and organize a new company, which was, as Mr. Buschmann said, legally done. The purpose of that, as I understood, was that our declared value was too low, or something like that, and that we could only increase that by dissolving the company, and that would give us certain tax privileges which we could legally take advantage of.

Now, do you recall whether or not at this meeting there was any discussion of whether the shareholders of the Pommerelle Company, Inc., the old company, would necessarily go over into the new company, or would have any option of selling out?

A. I think we had the option of selling out.

Q. Well, on what do you base that statement? Was there discussion of the matter at that meeting?

A. There was a discussion on that matter, but I don't know who said it, and I don't know, but that has always been my understanding that we could have done that.

(Deposition of C. S. Leede.)

Q. Well, is it your recollection that statements were made on that subject at the meeting?

A. Yes, that is my recollection.

Q. To what effect, Doctor? [113]

A. Well, that those that didn't want to come along could get out.

Q. Did you take stock in the new company?

A. Sure I did.

Q. And were you advised at any time afterwards about the amount of profit that you should report on the liquidation of your stock?

A. I haven't that with me, but I know I received a similar letter.

Q. You received a communication similar to that which Mr. Buschmann has identified as having been received by him, did you?

A. Yes. It was more extensive than that, because it was broken down for the children so that each one of the children would have to pay.

Q. You received the notification for yourself and for the children, did you? A. Yes.

Q. Did you make an income tax return for that year? A. Yes.

Q. Did you include in your income tax return, as income, the profits that you were advised you should report?

A. I personally did, yes.

Mr. Jones: Have you his return?

Mr. Winter: Yes.

Q. (By Mr. Jones): Mr. Winter has produced

(Deposition of C. S. Leede.)

a photostatic copy of your return, Doctor. Can you identify that as a copy of your return?

A. That is my handwriting.

Q. And your signature to it?

A. That is my signature. I didn't fill it out. [114]

Q. And are you willing that this return be produced and inspected in the course of the trial of this cause? A. Certainly.

Q. You are? A. Yes.

Q. Did you pay the tax that was shown to be due on your return?

A. I presume I did. I haven't been dunned yet.

Q. And have you ever claimed any refund from the government of any part of your tax on account of the profit on the Pommerelle Company, Inc., stock? A. No.

Q. Do you remember, Doctor, whether at this meeting of September 30, 1937, for dissolution, any statement was made to the stockholders about the profits that would be reportable as income if the company was dissolved?

A. I don't recall the figures, but I do know that —I don't know what we were capitalized for—was it $80,000 or something like that?—and they said that it isn't the value of the affair, and it should be up higher; and I am no accountant, so I took their word for it.

Mr. Jones: That is all.

(Deposition of C. S. Leede.)

Cross Examination

By Mr. Sager:

Q. Doctor, as I understand you, your impression that you got from the information and advice given you at that meeting was that, in order to get a higher declared value on the stock of the company for tax purposes, [115] it was necessary to disincorporate and reorganize under a new declared value? A. That was my impresison.

Q. And that information was given to you at this meeting on September 30, is that right?

A. Now you are asking me something that I——

Q. (Interrupting): Well, I will change that. Was it discussed at that meeting?

A. Oh, yes, we had discussion.

Q. Did you have any other meetings pursuant to this general scheme of disincorporating and reincorporating, or reorganizing a new corporation?

A. I think our Board of Directors, the officers meet and formulate this, and then the stockholders are called in. I really don't know. We haven't had any regular meetings, so I couldn't say.

Q. But you recall being at this meeting on September 30?

A. This meeting, yes, I recall that.

Q. Do you recall being at another meeting along about that same time, within a matter of a week or two of that same time?

A. That is possible.

(Deposition of C. S. Leede.)

Q. Now, Doctor, sometime along there you signed a subscription for the stock in the new corporation, didn't you? A. Yes.

Q. You stated here to Mr. Jones that the call and waiver of the first meeting of the new corporation—this was the old corporation, was it not? The call of September 30 that you signed for yourself and your children, is that true? [116]

A. Yes.

Q. Now, did you also, on the subscription for stock in the new corporation, did you sign the names of your children there, too?

A. I probably did. I would have to see.

Q. I will show that to you, Doctor, and ask you if this is your writing?

A. No, that isn't my writing.

Q. Is that the writing of your children in each instance?

A. No. No, that isn't my handwriting, no.

Q. And it is not the writing of your children either?

A. No, that isn't the writing of my children.

Q. Do you know who signed that for you, Doctor?

A. I don't know. I don't recognize the handwriting. It isn't Mrs. Leede's. I don't know.

Q. It is not your handwriting?

A. It isn't my handwriting.

Q. And these other names of Eleanore M. Leede and Dorothy and William Leede are not the handwritings of those children of yours?

(Deposition of C. S. Leede.)

A. No. They couldn't sign it, because they weren't here.

Q. You were acting for them? A. Yes.

Q. With respect to this corporation during that period of time? A. Yes.

Q. What portion of the total stock in the old company did you and your children own together, Doctor?

A. Well, at first the children subscribed alone. They had one-tenth—I think it was one-tenth, wasn't it? And [117] then one of the stockholders went out, and I bought part of his stock. Now, I don't know when that was. I wasn't an original owner personally, but my children were, and I was taking care of their affairs for them; so we had I think eleven, maybe eleven and a half per cent or something like that.

Q. In the old company?

A. In the old company.

Q. You had that at the time of its dissolution?

A. Yes.

Q. And you took that same proportion of stock in the new company? A. Yes.

Q. That is, you and your children together?

A. Yes.

Q. Do you know, Doctor, that that was the same manner in which the other stockholders changed their holdings from one to the other of the corporations? A. Well, I imagine it was.

Q. Was that the general understanding among

(Deposition of C. S. Leede.)
the stockholders at this meeting, that they would hold the same stock in the second corporation that they held in the first corporaion?

A. May I put it this way: We were all entitled to hold the same proportion in the other corporation. I would put it that way rather than the other way.

Q. And his subscription for stock is on that same basis, is it not?

A. Yes, that is on the same basis.

Q. Now, you say, Doctor, that you understood you could dispose of your holdings? [118]

A. Yes, sir.

Q. That, of course, was true at any time? You could have sold this stock pretty nearly any time, couldn't you? A. I didn't want to.

Q. I know, but I say you could have?

A. I could have, yes, certainly.

Q. And at this meeting, the proposal for taking up this stock of anyone who cared to dispose of it was an offer on the part of Mr. Braicks to purchase it?

A. I won't say it was an offer on the part of Mr. Braicks. I think it was on the part of any individual.

Q. Well, was there any other individual there that offered to buy stock?

A. I don't know that anybody offered to, but I certainly would have.

Q. You would have been willing to buy additional stock?

(Deposition of C. S. Leede.)

A. I would have been willing to buy some more stock.

Q. That was the only way, of course, that you could have disposed of it, by selling to some one of the other stockholders?

A. We are supposed to offer first to our fellow stockholders before we go outside the corporation.

Q. Was that the understanding among the stockholders?

A. That was a gentleman's agreement which we had from the start.

Q. A gentleman's agreement? A. Yes.

Q. Did that carry over into the new corporation?

A. I don't know whether that—we among ourselves have always felt that way about it, that we should have the privilege of buying first. [119]

Q. Was Mr. Scott at this meeting of September 30? A. Oh, yes.

Q. Did he submit these various papers for you to sign at that time?

A. I don't know whether he submitted them at that time or whether we just passed the resolution, or whether we came together at a later time to sign up the subscription for the stock. I couldn't tell you that. I don't know.

Q. I notice, Doctor, that this subscription—now, of course, you didn't sign this, did you, Doctor?

A. I may have. I don't know whether I gave a proxy to somebody to sign it for me. Those are not

(Deposition of C. S. Leede.)

my signatures. That is not my signature, and I don't know—was this around Christmas time? The children were home at Christmas and one or the other might have signed. But it doesn't look to me—this is not my handwriting and this could be Dorothy's, but I don't know. This is my handwriting.

Q. This is your handwriting?

Mr. Jones: Well, now, referring to what?

Q. (By Mr. Sager) Doctor, this that you say is your handwriting refers to a communication dated September 30, 1937, addressed to the Board of Directors of the Pommerelle Company, Seattle, Washington, and that was signed by you?

A. That was signed by me.

Q. And also the names of Eleanore M. Leede, Dorothy Leede and William Leede are written in your handwriting?

A. That is my handwriting. [120]

Q. And that is a proposal to the new company, in which you offer to sell, assign, transfer and turn over to The Pommerelle Company, in full payment of our individual subscriptions, our undivided ownerships and interests in the assets shown upon the attached list, subject to all liabilities which The Pommerelle Company is to assume and agree to pay? A. Yes.

Q. In other words, you made this proposal to the new company, to turn over your interest in the old company in payment of your subscription of stock, is that correct? A. Yes.

(Deposition of C. S. Leede.)

Q. Was that produced at that time?

A. What do you mean?

Q. I mean was that signed at that same meeting?

A. I couldn't tell you that, whether it was signed the same day or whether it was signed a few days later.

Q. Do you know whether or not it was signed on the date it bears?

A. I presume it was. I don't believe I looked at the date.

Q. Now, this meeting that you were holding, Doctor, was a meeting of the stockholders of the old company, that is correct, isn't it? A. Yes.

Q. And at that same meeting, you subscribed for the stock of the new company? A. Yes.

Q. And you——[121]

A. (Interrupting) I don't know whether I subscribed, whether we subscribed that day on the same thing. I can't recall, or whether it was a few days later. I wouldn't make that statement that on that date I signed it, but those are my signaures.

Q. Well, if there was another meeting concerning this whole transaction, it was right about the same time, within a few days or a week or so?

A. Yes, I think so.

Q. And you then offered to transfer your holdings in the old company to the new company?

A. Yes.

Q. For your stock in that new company, and the other stockholders did likewise? A. Yes.

(Deposition of C. S. Leede.)

Q. And that was the understanding among you at that time, was it not, subject to the right of any one of you to sell? A. That is it, yes.

Q. To one another? A. Yes.

Q. But you all knew that the same assets in the old company were going over to the new company?

A. Yes.

Q. The advice given to you during the course of these proceedings, was that given to you by the directors or by Mr. Scott?

A. I think Mr. Scott was the one that explained the whole procedure to us.

Q. He is the one who outlined this plan for you gentlemen?

A. He amplified it and gave us the information. [122]

Q. And it was upon his advice that you acted?

A. He acted as our adviser, I would put it that way.

Q. And these so-called best interests of the company that were spoken of by Mr. Buschmann, your understanding of that was that it would achieve a higher declared value on the stock?

A. Well, we were—yes. Now, I don't know value or declared valuation and taxable stuff; I am not a business man to know that, and I think there are two questions always there, on reorganization or declared valuation or taxable valuation, or what it is I don't know; but I had the impression that if

(Deposition of C. S. Leede.)

we would say that it is of a higher declared valuation, we would have to pay a higher tax, a corporation tax, but we would have a higher earning figure before we would come into the surtax or whatever it might be, something to that effect. Now, I may be all wrong.

Q. In simple language, Doctor, you were going to cut down the amount of tax the corporation was going to pay?

A. Yes, that is the point, that we would be able to have larger returns without having surtax, or something like that.

Q. And that was about the only change in the company, wasn't it? A. Well——

Q. What I mean, Doctor, you didn't change your operations, your mode of business?

A. No, but we were—we got where we could, on $500,000, we could make 5% or 6% on that, and that was more than you could make on $80,000, something to that effect. [123]

Q. You don't mean that you actually increased the amount of profit to the company by this reorganization? A. No, but we could——

Q. (Interrupting) You saved some on the tax?

A. We could have gone up; we would have saved tax, yes.

Mr. Sager: I think that is all.

Mr. Jones: That is all.

(Witness Excused.)

(Signed) C. S. LEEDE.

ED HULETZ,

called as a witness on behalf of the plaintiffs, being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. State your name, please.

A. Ed Huletz.

Q. Were you a stockholder of Pommerelle Company, Inc., in 1937? A. Yes.

Q. Showing you the call for special meeting of stockholders of September 30, 1937—I was going to ask you if your signature was on it, but I don't see that it is here. I will ask you, however, if you recall attending that meeting which dealt with the matter of dissolving the company?

A. Yes, I am quite certain I was there. [124]

Q. And do you recall what, if any, discussion there was relative to any opportunity afforded the stockholders either to receive the liquidation interest of the company, or to receive the equivalent in cash?

A. Yes, that was—I don't know if it was brought up at that meeting. I know distinctly I had the opportunity of doing either one.

Q. And can you state in substance what the information was that was given to the stockholders on that point?

A. That would be hard for me to do.

Q. Well, just state the substance of it, the fact of it. I don't mean the language.

(Deposition of Ed Huletz.)

A. The impression I had was that we had a chance to sell our stock at that particular time, or go on into the new company.

Q. And if you sold your stock, did you understand what you would get for it? A. Yes.

Q. How would that be determined?

A. I couldn't tell you. I remember to this extent, that our stock would have been better by coming into the new company. I think we would get some additional stock.

Q. Did you receive any advice from the company or anyone on its behalf as to the amount of profit you should report on your stock in connection with the dissolution?

A. Yes, I did at that time.

Q. Did you receive a communication substantially in the form of this communication which Mr. Buschmann has identified? [125] A. Yes.

Q. And did you report the amount of profit that you were advised had accrued to you on the transaction in your income tax return?

A. I don't know if I was in California at the time that that was forwarded to me, or if I was in Seattle. I remember of mailing it to my accountant at that time, and it was supposed to have been reported.

Mr. Jones: Have you Mr. Huletz' return?

Mr. Winter: He didn't file one as far as I recall.

The Witness: What year is that for?

(Deposition of Ed Huletz.)

Mr. Jones: For 1937.

The Witness: When is that due?

Mr. Winter: March of '38.

Q. (By Mr. Jones) Do you know whether or not you did file a return for 1937?

A. I didn't check, but it should have been, because I had an accountant at that time, Mr. J. W. Langford. I will check. However, at that time I had sold—I had a garage out in the Mount Baker District. I had sold that. However, I was informed by Mr. Chilberg, from the Internal Revenue, who phoned me and asked me about my place of business out in Mount Baker, asking me to come down——

Mr. Winter: (Interrupting) Is it the Mount Baker Garage?

The Witness: Yes, sir.

Mr. Winter: I was sure that that wasn't the return, Mr. Jones; but after seeing it now, I have it here. [126] I had difficulty getting this particular return. They sent me another one. Yes, I have it here. Do you want to ask him if that is his signature?

Mr. Jones: Yes, if you will submit it to him.

Mr. Winter: I will ask him if it is his signature. I will just show him the signature.

Q. (By Mr. Jones) Mr. Winter is showing you a return for 1937.

A. Yes, and that is my wife's.

Mr. Winter: E. A. Huletz and Madelyn L. Huletz.

(Deposition of Ed Huletz.)

Q. (By Mr. Jones) And are you willing that the return be received and inspected in connection with the trial of this case, Mr. Huletz?

A. Yes.

Q. As far as you recall, did you pay the tax due as shown on this return?

A. Well, I paid whatever tax—I am sure I did.

Q. And have you received any refund of tax on account of the profit on this liquidation of the Pommerelle Company, Inc. stock? Have you ever received any tax refund from the Government?

A. Not to my knowledge.

Mr. Jones: That is all.

Mr. Winter: Mr. Jones, did he state he had no objection to using the return?

Mr. Jones: Yes, he said that was all right. [127]

Cross Examination

By Mr. Winter:

Q. Who prepared your return, Mr. Huletz?

A. Mr. J. W. Langford. He is an accountant.

Q. You don't know whether or not you did report any income from this socalled liquidation, do you?

A. No. However, I am sure I told him.

Q. Well, just refer to your return.

A. Well, is it listed?

Q. I don't find it. Now, maybe you can find it.

A. No.

Q. Do you find that you reported it?

(Deposition of Ed Huletz.)

A. No.

Q. You didn't report any profit? A. No.

Q. How many shares of stock did you own in the corporation at that time?

A. I don't remember.

Q. Do you recall what amount was set forth in the instructions to you as to how you should report the profit that you should report, by Mrs. Pfisterer of the Pommerelle Company? Do you recall how much that was? A. No, I don't.

Q. When did you sell your stock in the new company?

A. I started a new business—I think it was in '38.

Q. Were you working for the old company at one time?

A. No. Oh, partially. No, I wasn't either.

Q. I beg your pardon? A. No.

Q. You don't recall when you purchased the stock, do you, [128] in the old company?

A. No, sir.

Mr. Jones: Do you want me to show you what I have here?

Mr. Winter: Yes, if you would.

Mr. Jones: The information that I have from the schedule prepared is that Mr. Huletz owned 595 shares, of which 350 was acquired on June 10, 1935, and 245 on December 14, 1936. Do you want me to state what the schedule shows as to cost and his reportable profit?

(Deposition of Ed Huletz.)

Mr. Winter: I think I have it here.

Q. (By Mr. Winter) Do you recall approximately what profit you were advised that you were to report upon this transaction, in connection with the liquidation and formation of the new corporation? Do you recall now the amount, approximately?

A. No, I really don't.

Q. Was it a hundred dollars? $200.00?

A. To tell you the truth, I don't know how much stock I bought originally.

Q. Well, did you attend any of the meetings of the corporation? A. Not many.

Q. To whom would you give your proxy?

A. Oh, I would usually drop it off at the store, Mr. Molz here.

Q. Are you a friend of Mr. Molz?

A. Yes, sir.

Q. Is that how you became associated in the company? A. Yes, sir.

Q. What did you understand as to what you were to receive [129] for your stock in the new corporation, in the event you wanted to sell it? I mean, what did you understand you would receive for your stock in the old corporation in the event you wanted to sell it at that time?

A. Well, I think the present share that was prevailing at that time, the present amount the stock was valued at.

Q. Did you attend the meeting of September 30?

A. I think I did, yes.

(Deposition of Ed Huletz.)

Q. What did you understand was the purpose of forming the new corporation?

A. Well, it was similar to the statements I have heard here, and that was that it was a benefit for the stockholders and the company to dissolve the old one and organize a new company.

Q. Did you understand that the same stockholders were going into the new company?

A. Well, I didn't know all the stockholders.

Q. Well, the ones you knew, you understood they were going into the new company?

A. Well, I knew Mr. Molz was. Other than that, I didn't know. No, I didn't. I knew some were going in.

Q. You knew it was just a matter of procedure whereby you would turn in your old stock and get new stock in the new corporation, is that right? So far as you were concerned, that is all that concerned you, wasn't it?

A. Well, no, it wasn't. At that time I wasn't interested. I figured I didn't want to sell my stock, and they were dissolving the company, so I just more or less assumed that there would be some drop out and be some new stockholders come in. [130]

Q. You just assumed that? A. Yes, sir.

Q. You were not present at many of the meetings? A. No, sir.

Q. To know what was discussed? You just were going along with them as to what they were doing, is that right? A. Well, yes.

(Deposition of Ed Huletz.)

Q. Did you understand that one of the purposes of the dissolution of the corporation was to increase the capital stock, that may be accomplished by dissolving the old corporation and organizing the new corporation? Is that what you understood?

A. Well, there were several things. However, I didn't pay much attention to it.

Q. Didn't you know about it?

A. Yes, I knew about it, that we were dissolving the old company and there was a new company going to be started.

Q. With the same assets?

A. Well, I didn't even pay any attention to that.

Q. You didn't pay any attention to that?

A. No, sir.

Q. Did they ever offer to buy your stock?

A. Oh, yes.

Q. When? Prior to the meeting, or subsequent?

A. Prior and afterwards.

Q. You did sell your stock, did you not?

A. Yes, sir.

Q. In 1938? A. Yes, sir.

Q. Who did you sell it to? [131]

A. To the Pommerelle Company, Mr. Molz.

Q. Mr. Molz?

A. I don't remember. I turned it in.

Q. The way I understand it, then, you were relying on whatever Mr. Molz did was satisfactory with you, is that right, in connection with your stock ownership? A. No.

(Deposition of Ed Huletz.)

Q. You relied upon Mr. Molz, didn't you, when you went in the company?

A. Well, in what way?

Q. Well, you believed in the company when you went into it, didn't you? A. Yes.

Q. And you gave Mr. Molz from time to time your proxy to represent you as a stockholder?

A. Yes.

Q. And you knew that whatever he did was satisfactory with you, is that right? A. Yes.

Q. And whatever he did in connection with the liquidation and subscription to new stock, it was satisfactory to you? A. Yes.

Q. You didn't sign a subscription blank, or did you sign a subscription for stock in the new company? A. I think I did.

Q. I will show you this sheet from the minute book of the company, and ask you if your signature appears on that subscription? A. Yes.

Q. When did you sign that, Mr. Huletz? [132]

A. I couldn't tell you.

Q. Well, was it before the meeting, the first meeting of the new company?

A. I couldn't tell you. I don't know.

Q. As a matter of fact, didn't you hear the situation discussed by other stockholders, other than Mr. Molz? I mean, the affairs of the corporation, as to what they were attempting to do?

A. Yes.

Q. Who else was it discussed by?

(Deposition of Ed Huletz.)

A. Mr. Braicks that I remember. Other than that, there might have been somebody else. No other name to my knowledge.

Q. Did you ever hear Mr. Scott discuss it?

A. Yes, I think so.

Q. Was that at one of the meetings you attended?

A. Yes, I did hear Mr. Scott.

Q. Did you hear Mr. Scott discuss that it would result in savings of tax if such a procedure was adopted? A. Not to my knowledge.

Q. Not to your knowledge? A. No, sir.

Q. Who did you hear make such a statement, if you did? A. I don't recall that I did.

Q. What did you understand was the purpose of liquidating the corporation and organizing a new corporation?

A. Well, to get a higher value for our stock.

Q. You knew that that was to avoid, or legally avoid—attempt to legally avoid the excess profit tax on low capitalization, is that right? [133]

A. Not to my knowledge.

Q. Well, you know that to be a fact, do you not? A. No, I don't.

Q. You don't? A. No, sir.

Q. You don't know very much about this thing, do you, Mr. Huletz?

A. No, sir; I did not.

Q. And whatever was done, was done by your friend Mr. Molz, was it not?

A. Well, I couldn't say that I would place the responsibility on him. I just put stock in the

(Deposition of Ed Huletz.)

company and let it ride, and I didn't pay any attention, because, to tell you the truth, it was such a small amount.

Q. You understood that if you just let it ride, then, that you would just get stock in the new corporation in the same proportion that you had in the old corporation, except for the higher capitalization, is that right?

A. Well, will you repeat the question?

Q. I will strike it, and I will put it this way: Did you understand that you were to receive stock in the same proportion in the new corporation that you owned in the old corporation?

A. Well, I knew we were going to get stock. I didn't know in what proportion.

Q. Well, you were turning in all of your stock?

A. I was surrendering all of my stock and not exchanging it for new stock in the corporation.

Q. For the stock in the new corporation?

A. No, but I was purchasing stock in the new corporation. [134]

Q. And that is what you understood to be a fact, wasn't it?

A. Yes, as I have stated above.

Q. That you were turning in your stock?

A. No, I was surrendering my stock.

Q. And you were receiving stock in the new corporation?

A. No, I was purchasing stock in the new corporation.

(Deposition of Ed Huletz.)

Q. Now, in case you sold your stock, as you say that they offered to purchase it, what did they say they were going to pay you for it?

A. Oh, there was no amount set on that.

Q. You weren't desirous of selling, I take it?

A. No, sir.

Q. Did you have an understanding with the rest of the stockholders that you couldn't sell your stock except to one of the other stockholders?

A. No.

Q. Who did you purchase your stock from, did you say?

A. From Mr. Molz, from the Pommerelle Company.

Q. Who do you say your accountant was that you told that he should include—that you sent this statement which was furnished to you by the Pommerelle Company relative to your profit on this transaction? A. J. W. Langford.

Q. Did you send it to him? A. Yes.

Q. Have you inquired as to whether or not he ever received it?

A. Well, I—no, I never inquired. I just assumed that it was all taken care of.

Q. Do you recall whether or not you were advised to report a profit of $640.98? [135]

A. Who by?

Q. By the secretary of the Pommerelle Company?

A. Yes, I understood that there was an excess

(Deposition of Ed Huletz.)

profit there that we were supposed to pay our income taxes—we were supposed to pay tax on that.

Q. Have you asked your accountant whether or not he ever received the letter on which you told him to report it? A. No.

Q. You signed your return?

A. Yes, I did.

Q. You read it before you signed it?

A. Very poorly.

Q. Well, isn't it a fact that the reason why you didn't include that is because you didn't have a profit because you didn't sell your stock?

A. Well I will have to take that up with my accountant.

Q. Well, didn't you understand that you were not selling your stock, but you were merely trading it for stock in the new corporation?

A. Yes.

Q. And as long as you didn't sell your stock, that you would have no taxable profit?

A. I thought we were supposed to—there was an increase at the exchange, wasn't there, when we switched the stock?

Q. You mean an increase in the value of the stock? A. Yes.

Q. Did you understand you were selling your stock or not?

A. No, I wasn't selling it.

Q. You were trading it for stock in the new corporation? A. Yes, sir. [136]

(Deposition of Ed Huletz.)

Q. Is that your understanding? A. Yes.

Q. Who advised you to that effect?

A. I do not remember.

Q. Well, did anyone advise you that that was in effect, what you were doing?

A. That is awfully hard for me to answer.

Q. Why didn't you report it in your return? Is that the only explanation, that you told your accountant to put it in? A. Yes, sir.

Q. How did you tell him?

A. Well, to tell you the truth, I don't know if I was in California at that time or not; if I mailed him that, or if I told him. I have no connections with this accountant at the present time. I haven't had for three years, and he usually fixed up my statement, and I would sign the statement and pay whatever tax I had to pay and I didn't——

Q. (Interrupting) You subscribed and swore to your return in Seattle. You couldn't have been in California when you signed your return.

A. Then I was in Seattle then.

Q. What is the fact now? Were you trading your stock for stock in the new corporation, and thought you didn't have a profit?

A. No; I thought there was a profit.

Q. Why didn't you report that profit?

A. Well, I would say my accountant was to blame for that.

Q. What did you have more after the new corporation was formed?

(Deposition of Ed Huletz.)

A. You mean additional value?

Q. Yes. What did you have additional that you didn't have [137] before?

A. I couldn't tell you. I don't know the amount.

Q. You understood that you were getting that much more money out of the corporation, and you were still having the same stock? Was that your understanding of the matter?

Mr. Jones: What do you mean by "that much more money", Mr. Winter?

Mr. Winter: Well, the witness may know.

Mr. Jones: Well, if you don't know what your question is, I don't know why the witness should know.

Mr. Winter: I do know what the question is, but if Counsel doesn't know——

Mr. Jones: (Interrupting) I asked you what you meant by "that much more money."

Mr. Winter: Well, let's see whether the witness knows what I mean.

The Witness: No, I don't know.

Mr. Jones: You mean you don't know the answer, or you don't know what Counsel means by his question?

The Witness: I don't quite understand him.

Q. (By Mr. Winter) You don't understand me? A. No.

Q. All right. You say you were expecting to get that much more money? Didn't you say that?

Mr. Jones: No, you were the one that said that, Mr. Winter.

(Deposition of Ed Huletz.)

Mr. Winter: No, I think he said it, and the record will bear me out, I think, that he said he got that much more money, and he was supposed to report it.

Q. (By Mr. Winter) Is that right?

A. Yes. [138]

Q. When you say "that much", you don't remember how much it was? A. No, sir.

Q. And that is the amount that you were advised by the secretary of the company in a letter that you should report? A. Yes, sir.

Q. Well, did you understand that you had sold your stock? A. No.

Q. Well, then how did you understand that, if you didn't sell your stock or dispose of it, that there would be a profit to you?

A. Well, I just more or less assumed that our stock had increased that much, increased in value.

Q. Did you ever authorize the liquidation of the old corporation?

A. I was in favor of it.

Q. Did you ever sign any statement that you had authorized the liquidation of the corporation?

A. I don't remember.

Q. You don't remember? A. No, sir.

Mr. Winter: That is all.

Redirect Examination

By Mr. Jones:

Q. Are you quite clear, Mr. Huletz, that you did convey to your accountant, Mr. Langford, the

(Deposition of Ed Huletz.)

information that was given to you by the company as to the amount of [139] profit that you should report on the transaction?

A. Yes, to my knowledge.

Q. Counsel has asked you whether you understood you were trading stock in the old company for the new company. I am not asking you what your understanding is, but I will just ask you if you signed the subscription here which is in the minute book of the new company, which I will show to you, under date of September 30, in which it is stated that the undersigned offer to sell, assign, transfer and turn over to The Pommerelle Company, in full payment of our individual subscriptions, our undivided ownership and interest in the assets shown upon the attached list, subject to all liabilities which The Pommerelle Company is to assume and agree to pay? Now, do you find whether you signed that or not?

A. Yes. That is my signature.

Q. That is your signature, the last one on that page? A. Yes, sir.

Q. And what were the assets in which you were assigning an interest there? What were those assets that you were assigning and turning over your interest in them for stock in the new company?

A. What do you mean, dollars and cents?

Q. No. You say you offer to turn over your undivided ownership and interest in the assets shown upon the attached list. Do you remember

(Deposition of Ed Huletz.)

what those assets were, whether they were the properties of the old company?

A. I would say yes.

Mr. Jones: That is all.

Mr. Winter: That is all.

(Witness Excused.) [140]

GILBERT M. KROLL,

called as a witness on behalf of the plaintiffs, being first duly sworn, testified as follows:

Direct Examination

By Mr. Jones:

Q. Will you state your name?

A. Gilbert M. Kroll.

Q. Were you a stockholder in the Pommerelle Company, Inc. in 1937, Mr. Kroll?

A. Yes, I was.

Q. Were you the owner of 850 shares in that company?

A. I don't remember the amount.

Q. Showing you the call for a special meeting of stockholders to be held on September 30, 1937, I will ask you if you signed that?

A. Yes, I did.

Q. G. M. Kroll is your signature, is it?

A. That is right.

Q. Did you attend that meeting?

A. I did partially, I imagine.

(Deposition of Gilbert M. Kroll.)

Q. And do you remember whether or not there was any discussion at that meeting to the effect that a stockholder who didn't want to continue could have some action taken about disposing of his stock?

Mr. Winter: I don't think Counsel needs to lead the witness.

Mr. Jones: Well, I am trying not to lead the witness.

A. I don't remember just what was said at that particular meeting, because I was more or less in charge of the plant, and I had a lot of other things to do. I was [141] in and out of the meeting. I wasn't there during the entire meeting.

Mr. Sager: I am having difficulty hearing the witness.

Mr. Winter: So am I. Will you speak a little louder?

A. I wasn't present at the entire meeting, so I do not remember what was said all the time in the meeting, because I was in charge of the plant, and I had things to do in the plant, and I had to answer the phone when it rang, I was the youngest one at the meeting, and naturally when something happened, I was the one that had to jump.

Q. (By Mr. Jones) Do you recall, Mr. Kroll, whether you were advised at some later date, by or on behalf of the company, of the amount of profit that should be reported on your return for 1937 on that transaction? A. Yes, I was.

(Deposition of Gilbert M. Kroll.)

Q. And did you receive a communication substantially of the same character as this exhibit 1 to Mr. Buschmann's testimony?

A. I imagine I did, although I don't clearly remember that I received it.

Q. Did you report a profit on the liquidation of your stock in your return for that year?

A. Yes, I did.

Mr. Jones: Do you have his return, Mr. Winter?

Mr. Winter: I do.

Q. (By Mr. Jones) Mr. Winter is showing you a photostatic copy—— [142]

A. (Interrupting) I have a copy of my return here.

Q. Well, take a look at this one, Mr. Kroll. He is showing you a photostatic copy of your return. Is that your signature? A. That is right.

Q. And are you willing that this return be produced and exhibited and inspected upon the trial of this cause, Mr. Kroll? A. Yes.

Mr. Jones: That is all.

Cross Examination

By Mr. Sager:

Q. Did you say, Mr. Kroll, that you were working for the company at that time? A. Yes.

Q. Are you still working for them?

A. No.

Q. How long did you work for the new company after the reorganization?

(Deposition of Gilbert M. Kroll.)

A. How long?

Q. I just want to know approximately.

A. Till July 31, 1940.

Q. Do you still own stock in the company?

A. No, I don't. I sold it at that time.

Q. You sold it at the time you quit?

A. Yes.

Q. Do you know what percentage of the stock in the old company you owned?

A. I don't know the percentage.

Q. You don't know the percentage? [143]

A. No.

Q. You were not there at the entire meeting?

A. No.

Q. Were you at any other meetings other than this meeting of September 30?

A. I did attend a few of the meetings, yes.

Q. About that same time?

A. About that time.

Q. Did they all have to do, all of these meetings, with this change from one corporation to the other?

A. Not particularly. We had meetings about other matters.

Q. Did you attend any other meetings than the one you spoke of, which had to do with the change from one corporation to another?

A. Not that I remember.

Q. At that meeting you signed this call and waiver? A. Yes.

(Deposition of Gilbert M. Kroll.)

Q. Of special meeting of the stockholders of the Pommerelle Company, Inc., did you?

A. That is my signature.

Q. And you signed it at the meeting?

A. Yes.

Q. Did you discuss with any of the other members of the stockholders of the corporation this change-over from one corporation to another?

A. I discussed it with Mr. Molz.

Q. Mr. Molz? With anyone else? A. No.

Q. Did you discuss it with Mr. Braicks?

A. No. [144]

Q. Now, what did Mr. Molz tell you was the purpose of the change-over?

A. Well, we discussed it in a conversational manner in the evenings after we got through work, and I never paid any attention to the actual reason for it. I do remember Mr. Molz telling me that the company was going to be liquidated, and I could sell my stock or I could stay out of the new company that was supposed to be formed, or I could buy myself back into the new company. Since I was working there, I told him, well, I don't imagine I would sell it, because I would put the money in the bank and probably draw it out as fast as I put it in, so I told him I would probably buy new stock in the new company.

Q. Did he tell you why they were making this change from one to the other?

A. Yes, he started explaining to me, but I told

(Deposition of Gilbert M. Kroll.)

him that I left that up to the trustees of the company, because I was too young to realize what it was about.

Q. To what extent did he explain it to you?

A. I don't remember what the details were, because I didn't pay much attention to it. I left it up to them.

Q. You were not a director of the company?

A. No, I wasn't.

Q. Now, showing you a communication directed to the Board of Directors of the Pommerelle Company, dated September 30, 1937, in which the signors offer to transfer their interests from the old company to the new company, did you sign that?

A. Yes. [145]

Q. Your name appears thereon?

A. That is right.

Q. Did you sign that also at this meeting?

A. I imagine at that meeting.

Q. That was a meeting of the stockholders of the old company, was it not? That was at the meeting of September 30 at any rate?

A. I suppose it was. The date is on there.

Q. Now, I am showing you also what purports to be a subscription to stock in the new company and ask you if you signed that? A. Yes, I did.

Q. Your name is there, and did you sign that at that same time with these other papers?

A. I do not remember.

Q. You do not remember? A. No.

(Deposition of Gilbert M. Kroll.)

Q. Do you remember signing it at any other time? A. No.

Q. You don't know when you signed it?

A. I do not remember when I signed it.

Q. In your discussion of this transaction with Mr. Molz, were you told that your interest in the new corporation would be in the same ratio as it had been in the old corporation?

A. I don't remember him making that statement.

Q. Do you know whether or not you acquired the same interest in the new corporation as you held in the old? A. No, I don't.

Q. How is that?

Mr. Jones: He said he didn't. [146]

A. I don't remember that.

Q. (By Mr. Sager) You don't remember? You made no effort to satisfy yourself about this transaction? A. No.

Q. You just simply relied on Mr. Molz' word that it was for your good, is that correct?

A. That is right.

Q. To whom did you sell your stock?

A. Dr. Leede.

Q. You sold it to Dr. Leede direct?

A. Yes.

Q. At the time of this meeting, you understood you could sell your stock in the old company?

A. Yes.

Q. Did anybody make you an offer for it?

A. No, they didn't.

(Deposition of Gilbert M. Kroll.)

Q. Did you know to whom you could sell it?

A. No, I never considered it.

Q. How is that?

A. I didn't consider selling it.

Q. They intimated or said at that meeting that you could sell your stock? A. Yes.

Q. Did they say to whom you could sell it?

A. No.

Q. Was Mr. Braicks there? A. Yes.

Q. Did he say that he would buy any stock that anyone wanted to sell?

A. I do not remember him saying it, because I wasn't there all the time. [147]

Mr. Sager: That is all.

Mr. Jones: That is all.

Mr. Winter: Mr. Jones, you asked whether or not I had any other returns of stockholders of this corporation.

Mr. Jones: Yes.

Mr. Winter: I have copies of John Kangley and Geraldine Kangley, his wife, a joint return; and of Eleanore Pfisterer; and pursuant to the demand that you made for production of all of the returns of all of the stockholders, the Bureau of Internal Revenue has no record of any returns having been filed, so I am informed, by William E. Leede, Eleanore M. Leede and Dorothy Leede.

Mr. Jones: All right. I overlooked one thing with this witness.

Mr. Winter: And I also have one for F. W. Wonn.

(Deposition of Gilbert M. Kroll.)

Redirect Examination

By Mr. Jones:

Q. Showing you a letter addressed to you February 15, 1938, from The Pommerelle Company, did you receive that letter? A. Yes.

Q. At or about the time it bears date?

A. Yes.

Mr. Jones: I offer it in evidence as part of his deposition. It is just one of those notifications.

(Letter addressed to the witness dated February 15, 1938, from The Pommerelle Company was marked Exhibit 2 by the Notary Public and is attached hereto and made a part hereof.) [148]

Q. (By Mr. Jones) Do you recall whether it had a statement of the details along with it, showing how the amount was arrived at?

A. It must have, because I have the details on my report.

Mr. Jones: All right, that is all.

(Witness excused)

State of Washington,
County of King—ss.

I, J. W. Greb, Jr., a Notary Public in and for the State of Washington, residing at Seattle in said County and State, do hereby certify:

That the annexed and foregoing depositions of the witnesses August Buschmann, C. S. Leede, Ed

Huletz and Gilbert M. Kroll, on behalf of the plaintiffs, were taken before me and reduced to typewriting under my direction at Seattle, in King County, State of Washington, on the 23d day of October 1941, at 3:00 p. m. pursuant to oral stipulation;

That the above-named witnesses before examination were by me duly sworn to testify the truth, the whole truth and nothing but the truth;

That the said depositions were submitted to the witnesses for examination, and after making any desired changes in form or substance, were then signed by the witnesses in my presence;

That the said depositions as above transcribed comprise a full, true and correct transcript of the testimony given by said witnesses including questions and answers and objections of counsel; [149]

That I am not of counsel nor attorney for either of the parties in the said depositions and caption named, nor in any way interested in the event of the cause named in said caption;

That Exhibits 1 and 2 were identified and offered in evidence, and are attached hereto and made a part hereof.

I have retained the said depositions in my possession for the purpose of forwarding the same by my own hand to the Clerk of the United States District Court at Tacoma, Washington.

In Witness Whereof, I have hereunto set my

hand and affixed my official seal this .... day of October, 1941.

(Signed) J. W. GREB, JR.

Notary Public in and for the State of Washington, residing at Seattle. [150]

Mr. Jones: I think, in the deposition I have called for the return of those various witnesses who have testified. Have you those here, Mr. Winter?

Mr. Winter: The way I recall it, Your Honor, I think each made no objection, said they could be produced.

The Court: (Indicating) You offer these—all of it?

Mr. Jones: If not, I do offer it now in evidence.

The Court: Let the record show I, personally, read the deposition of Mr. Huletz and Mr. Kroll. In view of the fact it was not read into the record, and I went outside of the courtroom, let the record show it was offered.

Mr. Winter: That is all.

The depositions of August Buschmann, C. S. Leede, Ed Huletz and Gilbert M. Kroll, were filed, by order of the Court, and made a part of the record herein.

Mr. Jones: What was the last Exhibit?

The Clerk: No. 8, was the last one.

Mr. Jones: I offer No. 9, return of August Buschmann.

Mr. Winter: No objection except as to the relevancy and materiality, the same objection——

The Court: (Interrupting) The same ruling. I will admit them on the same theory.

Mr. Jones: That is the return of August Buschmann. [151]

> Plaintiff's Exhibit No. 9, return of August Buschmann, admitted in evidence.

Mr. Jones: No. 10, return of Dr. Leede.

The Court: It will be admitted, subject to the same ruling.

Mr. Jones: No. 11, return of Gilbert M. Kroll.

The Court: It will be admitted, subject to the same objection and the same ruling.

> Plaintiff's Exhibits Nos. 10, return of C. S. Leede, and 11 return of Gilbert M. Kroll admitted in evidence.

Mr. Jones: I have here the return of E. A. Huletz, the witness who testified that he instructed his accountant to put in the amount that he was advised was his profit and he said the return doesn't show it. Counsel probably would like to have the return for whatever it is worth.

The Court: It may be admitted.

> Plaintiff's Exhibit No. 12, the return of E. A. Huletz, admitted in evidence.

Mr. Jones: Your Honor, I have the two witnesses I mentioned this morning,—Mr. Wayne, who is one of the principal stockholders and on officer of the Company, would, if here, testify, substantially, as did Mr. Braicks, the last witness on the

stand; Mr. Witherspoon, Vice President of the National Bank of Commerce, in Seattle, if here would testify in corroboration of Mr. Braicks' testimony, that Mr. Braicks did come to him about the time of this transaction, and told him he [152] wanted to be in a position, individually, to buy the interest of the stockholders of the old company that wanted to get out and not go on with the new and arranged for bank credit for that purpose.

The Court: Do you stipulate Mr. Witherspoon, if present, would so testify, Mr. Winter?

Mr. Winter: Well, I don't like to so admit, Your Honor. I have no way of knowing whether that would be his testimony or not; if I could have an opportunity to check it with Mr. Witherspoon and talk to him, I could tell as to whether or not he would say there was an agreement they could buy it up, individually, or whether or not it was his understanding it would be for the corporation. I have no way of knowing.

The Court: As I understood Mr. Braicks' testimony, the stockholders made arrangements for themselves to make the loan from the bank and divide the stock.

Mr. Jones: I would like to have the opportunity to present that testimony; if Counsel feels he wouldn't want to concede the witnesses would so testify, I would request my case be held open and I have permission to submit it; I feel I would hardly be justified in asking that regarding Mr. Witherspoon, possibly.

Mr. Winter: I think we will agree, if he were

present, he would so testify. Mr. Jones has always made that contention, both to the Agent and the Government he would so testify. I have no reason for denying it.

The Court: Without Mr. Witherspoon's testimony, assuming the Government has answering testimony, Mr. Braicks testified to that fact; Mr. Witherspoon's [153] testimony would be merely corroborative of Mr. Braicks' testimony.

Mr. Jones: That is true.

Mr. Winter: Our only chance would be to shake him on cross-examination and I doubt if it—we have no testimony contrary.

Mr. Jones: Would you concede Mr. Wonn, if here, would so testify, substantially as Mr. Braicks did?

Mr. Winter: Substantially, yes.

Mr. Jones: On those conditions, we rest.

Mr. Winter: We have no testimony, your Honor, except——

The Court: How do you spell Mr. Wonn's name?

Mr. Jones: W-o-n-n.

The Court: F. W. Wonn?

Mr. Jones: Yes, it is F. W. Wonn. He appears in the record as the Vice President of the Company, of the new Company.

Mr. Winter: Of course, we don't admit he reported any taxable profit on his return.

Mr. Jones: Have you got his return there?

Mr. Winter: Didn't Mr. Scott testify he represented him, he had his power of attorney?

Mr. Jones: I don't remember whether he did or not.

The Court: No, he testified as to Mr. Molz and Mr. Braicks, he didn't testify as to Mr. Wonn.

Mr. Winter: I think we can agree, that he did report on his return, without producing it but that he reported it as dividends and not as capital gain. [154]

Mr. Jones: If that is your statement as to the fact, I will accept it, that is what it shows.

Mr. Winter: Yes.

Mr. Jones: All right, I will accept that.

Mr. Winter: I won't disclose anything in this record that is not already shown. (Reads excerpt from an exhibit in evidence.)

Mr. Jones: Shows '18 there—may have ordered a dividend, $100.00; may have added to it.

The Court: May have owned some other stock some place?

Mr. Jones: Yes. I assume what Counsel means is he reported that dividends from the Pommerelle Company.

The Court: No, Domestic Corporation dividends.

Mr. Jones: Then that is probably the explanation of it.

The Court: Did you have any testimony?

Mr. Winter: No, Your Honor.

Mr. Jones: I don't know if Your Honor had a chance to read the Board of Tax Appeals' case?

The Court: No, but I would like to hear from you, as to the applicability of any of those cases.

Mr. Jones: All right. This is such a technical subject, I don't like to get too far off the tax in discussing it. (Further argument.)

The Court: Suppose they hadn't declared a dividend of these profits, they would have been subject to penalty under the undistributed profit tax.

Mr. Jones: That is right. [155]

The Court: If they can do what they did here—I think it is true there wasn't any deliberate effort on the part of these people to avoid a transaction from the undistributed profits tax; they wanted to solve some other tax problem and they have but if a corporation closely held by a small group do this, wouldn't it be possible for every corporation, where the stock is closely held, to avoid the undistributed profits tax by this mechanism?

Mr. Jones: I don't know whether I exactly follow?

The Court: Stockholders all around the country couldn't do this, but stock closely held, and if they wanted to avoid the payment of this——

Mr. Jones: (Interrupting) They weren't trying to avoid the payment of the undistributed profits tax.

(Further argument.)

The Court: I realize, so far as this particular act is concerned, it wasn't, primarily, a taxable measure. The theory is if you could adopt this tax law, it would solve some of our economic problems. The Congressional intent——

Mr. Jones: (Interrupting) It was a social-economic theory.

The Court: Now, if they hadn't, for the purpose of increasing their declared value, if they hadn't done that, just left the corporation as it was, they would either have had to have declared their undistributed profits in the form of dividends paid out to the stockholders, or paid a penalty tax for failure to do so. [156]

Mr. Jones: That is what they did.

(Further argument.)

The Court: So far as looking at it from the social-economic point of view, the belief was held at the time, if we could force these corporations to distribute their profits and get the money out—increase the purchasing power of the people, they would buy more goods, farm products—(I won't make a speech)——

Mr. Winter: (Interrupting) As dividends, as distinguished from capital gains.

The Court: So, when you got all through with this transaction, you had your new corporation, with your $61,000.00 in it and there hadn't been any distribution of the profits of the corporation—there hadn't been any money put out to the people so they could buy more clothes and farm products and you pay a penalty for failure to do it.

Mr. Winter: I don't think I can add much except if the Court desires a further brief.—I will say this trial came on, on such short notice, I would like to have an opportunity to digest the later cases. (Further argument)—or, if Your Honor desires further authorities?

The Court: I don't know if I desire further authorities. I don't feel that these cases are controlling. I felt, in reading the cases of the 5th Circuit, Judge *Judge* Hutcheson's decision, or opinion, was a much better statement of what I thought the law was than the majority, but I don't think that that is controlling here, that those cases are directly or sufficiently in point here to be controlling. However, it is a technical matter and [157] I want to go over it further. If you want to file a further brief, I would be glad to get it next week, if I could.

Mr. Winter: I won't burden Your Honor with a great deal of *verbage,* I will see Your Honor gets it this week.

The Court: I don't think it is subject to collateral tax by the tax authorities.

(Further argument of Counsel.)

Mr. Jones: You say you don't think these cases are controlling. I appreciate, under the evidence, you can decide the case on the facts without reference to those cases. I was wondering whether you thought we misapprehended the legal point, and assuming that the question is one of law and to the extent it is one of law, there is, either one case of the 5th Circuit or other cases * * (Further Argument.)

The Court: You didn't have here a real liquidation, real dissolution; it was just simply the use of a mechanism which resulted in a new corporation, precisely the same as the old corporation and

resulted, incidentally, in the (at least, desirability) to avoid paying penalty tax on undistributed profits division. I don't think this question—Subdivision VIII—is of particular importance.

Mr. Jones: If you say there was no dispute of the resolution in liquidation, then that is not true; if you say it is all "sham and no substance", then that might be true.

The Court: I don't say it is "sham and no substance." I think, as I view the testimony, in good faith they attempted to follow the advice of their [158] Tax Counsel for the purpose of increasing their declared value but my present impression is, by so doing, they also took the step that resulted in the avoidance of the penalty tax; I don't think that it is possible to avoid payment of the penalty tax by this sort of mechanism.

Mr. Jones: Then I think if that is your view, it does get down to and will have to be governed by whichever line of those cases you choose to follow.

The Court: That is the reason I want to read them all over again.

(Adjournment) [159]

[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF RECORD ON APPEAL

To the Clerk of the Above-Entitled Court:

Defendant, Thor W. Henricksen, Acting Collector of Internal Revenue for the District of Wash-

ington, hereby designates the entire record in this case to be contained in the record on appeal.

J. CHAS. DENNIS,
United States Attorney.
HARRY SAGER
Ass't United States Attorney.
THOMAS R. WINTER
Special Assistant to the Chief Counsel, Bureau of Internal Revenue.

Copy received this 6th day of Aug., 1942.

JONES & BRONSON
Attorneys for Plaintiffs.

[Endorsed]: Filed Aug. 8, 1942. [179]

[Title of District Court and Cause.]

SUPPLEMENTAL DESIGNATION OF CONTENTS OF RECORD ON APPEAL

To the Clerk of the Above-Entitled Court:

Defendant, Thor W. Henricksen, Acting Collector of Internal Revenue for the District of Washington, having heretofore designated the entire record in this case to be contained in the record on appeal, more particularly designates this record as follows:

1. Complaint.
2. Answer.
3. Opinion.

4. Findings of Fact and Conclusions of Law.
5. Judgment.
6. Stipulation and Order Correcting Judgment.
7. Notice of Appeal.
8. Order extending time for Filing Record on Appeal and Docketing Action.
9. All exhibits.
10. Transcript of testimony taken at trial.
11. Defendant's Designation of Contents of Record on Appeal. [180]
12. This Supplemental Designation of Contents of Record on Appeal.

J. CHARLES DENNIS
United States Attorney.

HARRY SAGER
Assistant United States Attorney.

THOMAS R. WINTER
Special Assistant to the Chief Counsel for the Bureau of Internal Revenue.

Received copy this 19th day of Aug., 1942.

JONES & BRONSON
Attorneys for Plaintiffs.

[Endorsed]: Filed Aug. 20, 1942. [181]

In the United States District Court for the Western District of Washington, Southern Division

RECORD OF PROCEEDINGS:

At a regular session of the United States District Court for the Western District of Washington, held at Tacoma, in the Southern Division thereof, on the 25th day of August, 1942, the Honorable Charles H. Leavy, U. S. District Judge, presiding, among other proceedings had were the following, truly taken and correctly copied from the Journal Record of said Court, to-wit:

No. 189

[Title of Cause.]

MINUTE ORDER

On this 25th day of August, 1942, on motion of Thomas R. Winter, attorney for defendant, for an order to transmit the original exhibits admitted in evidence in the trial of this cause and for order to transmit the original depositions of August Buschmann, C. S. Leede, Ed Huletz and Gilbert M. Kroll, together with exhibits thereto attached, to the Circuit Court of Appeals, with the Transcript of the Record on Appeal herein,

It Is Ordered that the Clerk of this Court be and he is hereby directed to transmit to the Circuit Court of Appeals for the Ninth Circuit, with the Transcript of the Record on Appeal herein, the original exhibits in this cause, to-wit: Plaintiffs'

Exhibits Nos. 1 to 12, inclusive, and he is further directed to transmit the original depositions [182] of August Buschmann, C. S. Leede, Ed Huletz and Gilbert M. Kroll, together with exhibits thereto attached. [183]

[Title of District Court and Cause.]

STATEMENT OF POINTS

The appellant, Thor W. Henricksen, will rely upon the following points in the presecution of his appeal from the judgment of the United States District Court for the Western District of Washington, Southern Division:

I.

The District Court erred in entering judgment for the appellees and against the appellant for $8,338.98 and interest; conversely, the Court erred in failing and refusing to enter judgment for the appellant dismissing appellees' suit, with costs.

II.

The District Court erred in finding and concluding that the Pommerelle Company, Inc. distributed its assets to its stockholders on October 4, 1937. Conversely, the Court erred in failing to hold that the assets of the Pommerelle Company,. Inc. were transferred and conveyed by it directly to the newley organized Pommerelle Company.

III.

The District Court erred in failing and refusing to hold that the Pommerelle Company, Inc. was not entitled to a dividends paid credit for 1937 within the meaning of Section 27 of the Revenue Act of 1936 in that the transaction [184] in controversy constituted a non-taxable reorganization and not a liquidation of the Pommerelle Company, Inc.

J. CHARLES DENNIS,
United States Attorney.
HARRY SAGER,
Ass't United States Attorney.
THOMAS R. WINTER,
Special Assistant to the Chief Counsel, Bureau of Internal Revenue.

[Endorsed]: Filed Aug. 20, 1942. [185]

[Title of District Court and Cause.]

CLERK'S CERTIFICATE TO TRANSCRIPT OF RECORD

I, Judson W. Shorett, Clerk of the District Court of the United States for the Western District of Washington, do hereby certify and return that the foregoing Transcript of the Record on Appeal, consisting of pages numbered 1 to 185, inclusive, is a full, true and correct copy of so much of the record, papers and proceedings in Cause No. 189,

W. Braicks and J. G. Molz, liquidating trustees of Pommerelle Company, Inc., a corporation, Plaintiffs and Appellees, vs. Thor W. Henricksen, Acting Collector of Internal Revenue, Defendant and Appellant, as required by the Designation and Supplemental Designation of the Defendant-Appellant of the Contents of the Record on Appeal, on file and of record in my office at Tacoma, Washington, the same constituting the Transcript of the Record on Appeal from the Judgment of the District Court of the United States for the Western District of Washington, Southern Division, to the United States Circuit Court of Appeals for the Ninth Circuit.

I do further certify that original exhibits, numbered as follows, to-wit: Plaintiffs' Exhibits Nos. 1 to 12, inclusive, are transmitted herewith, pursuant to order of the District Court herein; that original depositions of August Buschmann, C. S. Leede, Ed Huletz and Gilbert M. Kroll, together with exhibits attached thereto, are herewith transmitted, pursuant to order of the District Court.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said Court, at the City of Tacoma, State of Washington, this 26th day of August, 1942.

[Seal] JUDSON W. SHORETT,

Clerk.

By E. REDMAYNE,

Deputy.

[Endorsed]: Filed Aug. 20, 1942.

[Endorsed]: No. 10233. United States Circuit Court of Appeals for the Ninth Circuit. Thor W. Henricksen, Acting Collector of Internal Revenue, Appellant, vs. W. Braicks and J. G. Molz, Liquidating Trustees of Pommerelle Company, Inc., a Corporation, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Western District of Washington, Southern Division.

Filed August 28, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit
No. 10233

W. BRAICKS and J. G. MOLZ, liquidating trustees of POMMERELLE COMPANY, INC., a corporation,

Appellees,

vs.

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Appellant.

APPELLANT'S STATEMENT OF POINTS AND DESIGNATION OF RECORD FOR PRINTING

Comes now Thor W. Henricksen, Acting Collector of Internal Revenue, appellant above named,

and for his Statement of Points upon which he intends to rely on this appeal adopts the Statement of Points filed by him in the District Court in connection with his Notice of Appeal and included in the transcript of record prepared and certified by the Clerk of said District Court at page 37 thereof; and appellant designates the entire transcript of the record as prepared and certified by the Clerk of said Court as necessary for consideration of this appeal.

J. CHARLES DENNIS
HARRY SAGER
THOMAS R. WINTER
Attorneys for Appellant.

[Endorsed]: Filed Aug. 31, 1942.

[Title of Circuit Court of Appeals and Cause.]

STIPULATION FOR SUPPLEMENTAL DESIGNATION OF RECORD FOR PRINTING

It is hereby stipulated by and between the appellant and the appellees that the following portions of the exhibits be printed:

1. Letters of February 15, 1938, and February 16, 1938, to August Buschmann, Pommerelle Company (Exhibit attached to original deposition marked by reporter as Exhibit 1.)

2. Plaintiff's Exhibit 1, Ninety-day letter (Reporter's original transcript, page 24).

3. So-called liquidating statement, together with the list of stockholders and the amounts of so-called liquidating dividends distributed to them (Attached to Plaintiff's Exhibit 2) (Reporter's original transcript, page 25).

4. All minutes, subscriptions and records appearing in Plaintiff's Exhibit 5 from September 26, 1937, to October 4, 1937, inclusive (Reporter's original transcript, page 29).

5. All minutes, subscriptions and records except Articles of Incorporation and By-Laws appearing in Plaintiff's Exhibit 6, from date of incorporation to October 4, 1937, inclusive. (Reporter's original transcript, page 31).

6. Plaintiff's Exhibit 7, statement of witness Scott (Reporter's original transcript, page 50).

7. This stipulation.

It is further stipulated that Plaintiff's Exhibits 8, 9, 10, 11, and 12, being photostat copies of income tax returns of stockholders, A. Vanderspek, August Buschmann, C. S. Leede, Gilbert M. Kroll and E. A. Huletz for the year 1937 show that these stockholders reported on their returns the amount of the so-called liquidating dividends shown in Plaintiff's Exhibit 7 and for that reason are not necessary for consideration of this appeal except as to that fact.

It is further stipulated that the other original exhibits on file being Plaintiff's Exhibits 3 and 4 are in most respects not of a printable character and may be inspected by the Court without the

necessity of printing. Application is therefore made for such inspection without printing.

J. CHAS. DENNIS
HARRY SAGER
THOMAS R. WINTER
Attorneys for Appellant
JONES & BRONSON
H. B. JONES
Attorneys for Appellees

[Endorsed]: Filed Sep. 16, 1942.

No. 10233

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Appellant

vs.

W. BRAICKS and J. G. MOLZ, Liquidating Trustees of Pommerelle Company, Inc., a Corporation,

Appellees

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR THE APPELLANT

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
A. F. PRESCOTT,
PAUL R. RUSSELL,
Special Assistants to the Attorney General.

J. CHARLES DENNIS,
United States Attorney.

HARRY SAGER,
Assistant United States Attorney.

THOMAS R. WINTER,
Special Assistant to the Chief Counsel.

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No. 10233

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Appellant

vs.

W. BRAICKS and J. G. MOLZ, Liquidating Trustees of Pommerelle Company, Inc., a Corporation,

Appellees

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR THE APPELLANT

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
A. F. PRESCOTT,
PAUL R. RUSSELL,
Special Assistants to the Attorney General.

J. CHARLES DENNIS,
United States Attorney.

HARRY SAGER,
Assistant United States Attorney.

THOMAS R. WINTER,
Special Assistant to the Chief Counsel.

BALLARD NEWS, SEATTLE, WASHINGTON -- 11/6/42 -- 45 COPIES

INDEX

CITATIONS

Cases:

No. 10233

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

THOR W. HENRICKSEN, Acting Collector of Internal Revenue,

Appellant

vs.

W. BRAICKS and J. G. MOLZ, Liquidating Trustees of Pommerelle Company, Inc., a Corporation,

Appellees

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF FOR THE APPELLANT

OPINION BELOW

The opinion of the District Court (R. 15-34) is reported in 43 F. Supp. 254.

JURISDICTION

This is an appeal from a judgment entered March 4, 1942, and amended May 8, 1942, by the Dis-

trict Court in favor of the appellees, liquidating trustees of the Pommerelle Company, Inc., for $8,338.98 with interest. (R. 43-46.) Appellees' complaint sought recovery from the appellant, the Acting Collector of Internal Revenue, of corporation income and excess-profits taxes and interest for 1937 assessed against and paid to him by Pommerelle Company, Inc., in the sum of $8,338.98, together with interest from the date of payment. (R. 2-7.) The action arose under the Internal Revenue laws of the United States (Sections 23 and 27 of the Revenue Act of 1936), jurisdiction having been vested in the United States District Court under Section 24, Fifth, Judicial Code. The case is brought to this Court by notice of appeal filed June 1, 1942. (R. 46-47.) The jurisdiction of this Court is invoked by virtue of the provisions of Section 128(a) of the Judicial Code, as amended.

QUESTION PRESENTED

In 1937 the stockholders of the taxpayer corporation appointed appellees as liquidating trustees to liquidate the company and wind up its affairs. This action was taken upon the advice of tax counsel for the sole purpose of effecting a reduction in the company's excess-profits taxes through the organization of a new corporation. Although the corporate debts

were not paid, and no formal instruments were executed assigning and conveying the assets to the stockholders, the trustees prepared a statement listing the *pro rata* share of each stockholder in the capital and surplus shown on the books and advised the stockholders to report as income in their respective income tax returns the respective amounts of the liquidating dividend to which they would have been entitled based upon such statement. Thereupon the liquidating trustees assigned the assets (subject to the liabilities) directly to a new corporation, organized for the purpose of carrying on the business, whose stock was issued ratably to the stockholders of the old company in exchange. Under Section 27(f) of the Revenue Act of 1936, is the taxpayer entitled to a dividends paid credit for the purported liquidating dividend to its stockholders?

STATUTES INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14.—SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means

the net income minus the sum of—

(A) The normal tax imposed by section 13.

* * *

(c) *Adjusted Net Income Less Than $50,000.*—

(1) Specific credit.—If the adjusted net income is less than $50,000, there shall be allowed a specific credit equal to the portion of the undistributed net income which is in excess of 10 per centum of the adjusted net income and not in excess of $5,000, such credit to be applied as provided in paragraph (2).

(2) Application of specific credit.—If the corporation is entitled to a specific credit, the tax shall be equal to the sum of the following:

(A) A tax computed under subsection (b) upon the amount of the undistributed net income reduced by the amount of the specific credit, plus

(B) 7 per centum of the amount of the specific credit.

* * *

SEC. 27.—CORPORATION CREDIT FOR DIVIDENDS PAID.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

* * *

(f) *Distributions in Liquidation.* — In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes

of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

* * *

(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * *

(g) *Definition of Reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

Remington's Revised Statutes of Washington, Vol. 5, 1940 Annual Pocket Part:

Sec. 3803-52. *Trustees—Powers and Duties.*

1. The trustee or trustees appointed by the shareholders to conduct a winding up out of court shall, as speedily as possible after his or their appointment has become operative as provided in section 3803-49, proceed.

a. to collect all sums due or owing to the corporation;

b. to sell and convert into cash any and all corporate assets;

c. to collect the whole, or so much as may be necessary or just, of any amounts remaining unpaid on subscriptions to shares, and

d. out of the sums so realized, to pay all debts and liabilities of the corporation according to their respective priorities.

2. Any surplus remaining after paying off all debts and liabilities of the corporation shall be paid by the trustee or trustees to the shareholders according to their respective rights and preferences.

3. Nothing in this section shall interfere with a reorganization pursuant to provisions hereinafter contained in this act.

Sec. 3803-56. *Commencement of dissolution proceedings — Effect.*

1. A proceeding for dissolution shall be deemed to commence

a. at the time of the passage of the resolution therefor, if the proceeding is out of court;

* * *

2. When a proceeding for dissolution has commenced,

a. the authority and duties of the directors and officers of the corporation shall cease, except in so far as may be necessary to preserve the corporate assets, or in so far as they may be continued by the trustee or receiver, or as may be necessary for the calling of meetings of shareholders;

* * *

STATEMENT

W. Braicks and J. G. Molz, appellees herein, instituted this suit as liquidating trustees of the Pommerelle Company, Inc., a corporation organized in 1934 (R. 35, 112) and having its principal place of business in the State of Washington, for the recovery of $8,338.98, corporation income and excess-profits taxes and interest paid to the Collector of Internal Revenue, the appellant, with interest (R. 2-7, 35-36, 39-40). The controversy brought to this Court upon appeal relates to a dividends paid credit claimed by the taxpayer for 1937 by reason of the alleged distribution of $61,423.39 to its stockholders. (R. 39, 82.) The Commissioner of Internal Revenue concluded that the steps taken amounted to a reorganization of the taxpayer, that in fact no taxable dividend had been paid to the stockholders, and that the corporation was

not entitled to a dividends paid credit by reason of the purported distribution. (R. 75-79.) The income and excess-profits tax liability for 1937 having been assessed and paid upon the basis of the Commissioner's determination, a claim for refund was filed on April 9, 1940, alleging that the Commissioner's action was erroneous in respect of the credit disallowed. (R. 8-12, 39-40.) The Commissioner having failed to allow the claim, the instant suit was begun on October 22, 1940. (R. 2-12, 40.)

The facts relevant to the controversy may be briefly stated. In September, 1937, the directors of the Pommerelle Company, Inc., concluded that the stated value of the company's capital stock was too low with the result that the corporation was paying excess-profits taxes in an amount larger than the company's situation required. (R. 37.) For the sole purpose of attempting to correct this situation and on the advice of tax counsel, proceedings were instituted for the liquidation of the corporation and a resolution was passed duly appointing the appellees herein as trustees to wind up and liquidate the assets and affairs of the company and to conduct a voluntary liquidation and dissolution out of court in accordance with the laws of the State of Washington. (R. 37.)

According to the minutes introduced in evidence the new corporation "The Pommerelle Company" was organized about September 25, 1937, by the stockholders of the old company. (R. 38, 94-97.) The new corporation was organized prior to dissolution of the old to prevent any hiatus in the corporate existence which might affect the company's wine and blender's basic permit or its standing with the Federal Alcohol Tax Unit. (R. 109-110, 115-116, 145.) The minutes indicate that on September 28, 1937, the stockholders of the old company subscribed to the stock of the new corporation in amounts equal to their respective shares in the net worth of the old company as reflected in its balance sheet of October 4, 1937. (1) (R. 38, 100-101, 104.) On September 30, 1937, the minutes record the authorization for the liquidation of the old company and the appointment of appellees as liquidating trustees with power to execute all papers and documents required in connection with the company's dissolution. (R. 88-89.)

At a special meeting of the stockholders of the old company held on October 4, 1937, the appellees re-

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(1) Some of the stockholders did not sign the subscription list on which their names appeared, their signatures having been affixed by others. (R. 161-162.)

ported "that they had liquidated the assets and affairs of the company by distributing the same to stockholders of record in undivided portions in the amounts set opposite their names." (R. 89-90.) The amounts listed opposite the names of the stockholders aggregated $61,423.39, which was the net worth of the corporation on October 4, 1937, as reflected in its books of account. (R. 90, 102-104.) The stockholders present thereupon voted to approve the report of the trustees and to accept their proportionate shares of the assets of the company. (R. 90.) No bill of sale, deed or other instrument was executed to effect the transfer of the corporate assets to the individual stockholders. (R. 115, 119.)

On the same day that the liquidating trustees reported they had distributed the "assets and affairs" of the taxpayer corporation to the stockholders, the new company voted to accept an offer to take over the assets of the old company and to assume its liabilities in payment of subscriptions to its stock. (R. 90, 106.) The offer referred to, as set forth in the minutes of October 4, 1937, was dated September 30, 1937, and purported to enclose a balance sheet dated October 4, 1937. (R. 101-104.) The subscribers were the stockholders of the original corporation whose proportionate interests in the enterprise were continued in the

new corporation without change. (R. 101-102, 118.) The liquidating trustees then executed formal instruments to effect the transfer of the assets to the successor corporation which issued its stock therefor. (R. 38-39.) There was some discussion of the possibility of paying off in cash any stockholder who might not wish to continue with the enterprise, but no one withdrew. (R. 143-144.) The assets and liabilities were then entered upon the books of the new corporation exactly as they had theretofore been carried on the books of the predecessor. (R. 118.) A contract for the purchase of real estate was overlooked at the time and an instrument to effect the transfer of this interest in real estate was not executed until a later date. (R. 114-115, 119, 146-147.)

The court below held that as the result of the foregoing steps " * * * the assets of the corporation were transferred to and vested in the plaintiffs (appellees) as trustees for the stockholders and as liquidating trustees for the company." (R. 37.) Commenting that any stockholders who did not wish to continue with the new company could have disposed of his proportionate share in the assets held by the trustees, (2) the trial court concluded that the transfer by appellees of the assets to the new corporation was made by them as trustees for the individual stock-

holders and not as liquidating trustees of the old company. (R. 41.) With respect to the Commissioner's conclusion that the steps amounted merely to a reorganization of the taxpayer corporation, the District Court held that the continuity of interest requisite to a statutory reorganization did not exist. (R. 41.)

With reference to the amount of the dividends paid credit, the sum claimed in the taxpayer's return for 1937 was $61,423.39; however, the evidence shows that the accumulated earnings and profits available for distribution at the date of the alleged dividend amounted to only $35,923.39. (R. 81-82.) Apparently, the remainder of the distribution of $61,423.39 represented capital invested in the enterprise. (R. 129.) All but one of the stockholders paid individual taxes upon their shares of the liquidating dividend. (R. 38.) Claims for refund have been filed on behalf of some of the stockholders

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(2) The evidence to support this observation was to the effect that financial arrangements were made so that any stockholder who might wish to do so could sell his interest (R. 132, 151, 163), but no price was fixed in case anyone should have wanted to sell (R. 180), some of the stockholders did not know to whom to sell should they want to withdraw (R. 157-158, 193), and all understood that the assets of the old company were to be transferred to the new company (R. 167).

to protect their interests in case it is held no taxable distribution was effected. (R. 136.)

An issue with respect to the deductibility of certain expenditures which was decided adversely to the Collector by the court below need not be discussed here since the appeal relates solely to the issue relative to the dividends paid credit.

STATEMENT OF POINTS TO BE URGED

The District Court erred in entering judgment for the appellees and against the appellant for $8,338.98 and interest; conversely, the court erred in failing and refusing to enter judgment for the appellant dismissing appellees' suit, with costs.

The District Court erred in finding and concluding that the Pommerelle Company, Inc., distributed its assets to its stockholders on October 4, 1937. Conversely, the court erred in failing to hold that the assets of the Pommerelle Company, Inc., were transferred and conveyed by it directly to the newly organized Pommerelle Company.

The District Court erred in failing and refusing to hold that the Pommerelle Company, Inc., was not entitled to a dividends paid credit for 1937 within the

meaning of Section 27 of the Revenue Act of 1936 in that the transaction in controversy constituted a non-taxable reorganization and not a liquidation of the Pommerelle Company, Inc.

SUMMARY OF ARGUMENT

The assets of the Pommerelle Company, Inc., were transferred directly to the new Pommerelle Company; they were not distributed to the stockholders of the original corporation as a liquidating dividend. The steps taken, including the authorization of the distribution in liquidation of the properties and assets of the predecessor corporation to its stockholders, the preparation of a list showing the *pro-rata* shares of the stockholders in the dividend authorized and the reporting of the dividends by the majority of the stockholders as income in their respective income tax returns were insufficient to effect the distribution contemplated. Therefore, the Commissioner's disallowance of the dividends paid credit claimed in respect of the alleged dividend was proper.

Moreover, apart from the failure of appellees to comply with formal requirements for transferring interests in real and personal property, looking to the substance of the matter, no distribution to the stock-

holders was effected. Viewing the transaction as a whole it is plain that the parties in control merely reorganized the company upon the advice of their accountant, believing a saving in the annual excess-profits taxes could thus be effected. We submit further that if a wholly unnecessary step had been taken in connection with the reorganization such as the purported distribution of the properties and assets to the stockholders immediately preceding the transfer thereof to the new company by the liquidating trustees, this should not lead to a tax result differing from that which would have followed had the reorganization been effected by the natural and simple procedure of a transfer direct from the original company to its successor.

ARGUMENT

I.

THE ASSETS OF THE TAXPAYER CORPORATION WERE TRANSFERRED DIRECTLY TO ITS SUCCESSOR BY THE LIQUIDATING TRUSTEES; THEY WERE NOT DISTRIBUTED TO THE STOCKHOLDERS AS LIQUIDATING DIVIDENDS

Under Section 3803-52, Remington's Revised Statutes of Washington, Vol. 5, 1940 Annual Pocket

Part, *supra,* proceedings for dissolution commence upon the adoption of a resolution providing for the liquidation of a corporation. Plainly the adoption of such resolution does not in itself accomplish the dissolution and liquidation of the company. The statute provides that the trustees in liquidation shall proceed to convert the corporate property into cash and to pay off all debts and liabilities, except in case of reorganizations. Attention is invited particularly to the exception.

We find nothing unique in Washington law insofar as the fiduciary relationship between liquidating trustees and the corporation in process of dissolution is concerned. Accordingly, we think that the appellees herein were acting for the Pommerelle Company, Inc., pursuant to their appointment as liquidating trustees when they assigned its assets to the new Pommerelle Company in October, 1937. The decision of the court below was predicated upon its conclusion that their assignment of the assets to the new company was made by appellees acting for the individual stockholders. This, we think, was erroneous.

The record shows that, acting upon the advice of an accountant, those controlling the Pommerelle Company, Inc., contemplated the dissolution of the existing

corporation and the organization of a new company to take over its going and profitable business. Consistent with the advice of the accountant, it was planned to divide the reorganization into two separate steps. In the first place a liquidating dividend was to be declared. Secondly, the stockholders were to assign their dividends to the newly organized company in exchange for its stock. However, we think that this plan was not carried out, in that there was no liquidation of the assets, no payment of the debts, and no distribution of the net proceeds to the stockholders. On the contrary, the evidence shows in our oponion that the liquidating trustees assigned the assets directly to the new corporation, subject to the outstanding debts. Whether the literal consummation of the plan in two steps involving the formal payment of the dividend, followed immediately with the retransfer of the assets to the new company would have justified the court in holding that the taxpayer paid a dividend to its stockholders, thus entitling it to a dividends paid credit, is doubtful in our opinion but we shall discuss this point in the second part of our argument. We should like to present first our reasons for believing that there was in fact no liquidating distribution to the stockholders.

Perhaps the most glaring omission in carrying

through the first step of the plan lay in the failure of the liquidating trustees to execute any instrument to transfer and convey the original company's interests in property and other assets to the stockholders. Moreover, the debts were not liquidated and there was no written undertaking by the stockholders providing for their assumption of such debts. A contract for the purchase of real estate was completely overlooked until long afterward. In our opinion there was at most a mere intention to route the assets to the new corporation via the stockholders, and such intention was not translated into accomplished fact.

Although the court below seems to have recognized that no actual distribution was made to the individual stockholders, its opinion suggests that they had certain rights and might have insisted upon receiving their proportionate shares in the assets from the liquidating trustees. (R. 28.)

Accordingly, a closer scrutiny of the mechanics of the transaction seems necessary. If the minutes could be relied upon, there was a half-hour's interval between the time (10:00 a. m., October 4, 1937) the liquidating trustees of the Pommerelle Company, Inc., reported to the stockholders that they had distributed the assets to the stockholders in undivided portions

and the time (10:30 a. m., October 4, 1937) the new company voted to accept the offer of the assets subject to the liabilities in payment of stock subscriptions. (R. 89, 105.) However, that the minutes are unreliable is demonstrated by the fact that the letter offering the assets to the new company was dated September 30, but purported to include a balance sheet dated October 4! (R. 101-104.) Further evidence of the unreliability of the minutes is found in the circumstance that a list of the stockholders, who allegedly subscribed on September 28 to the stock of the new corporation, showed subscriptions to the new stock in amounts exactly sufficient (disregarding sums less than $1) to absorb the capital and surplus as reflected in the balance sheet of October 4. (R. 101-106.)

From the testimony of appellees' witnesses when questioned concerning their receipt of the alleged dividends, it is inferable that the dividends were to them purely a matter of bookkeeping. (R. 64, 146-148, 166-167, 180-181, 190-191.) In this connection we invite attention to the well settled rule that realities and not bookkeeping entries are controlling in the matter of determining income. *Southern Pac. R. Co. v. Muenter*, 260 Fed, 837 (C.C.A. 9th); *Doyle v. Mitchell Brothers Co.*, 247 U.S. 179. Since appellees admit that no bill of sale or other instrument was executed

to effect the assignment and conveyance of the assets to the stockholders (R. 115, 118-119), the conclusion of the trial court that the trustees were acting for the stockholders conflicts with the generally accepted rule that liquidating trustees of a corporation act on behalf of the company in dissolution.

Aside from the fact the times and dates of the purported steps taken to dissolve the taxpayer and to transfer its going business to a new corporation were obviously recorded in the minutes to suit the purpose of the parties instead of constituting a true chronological record of the events, as they occurred, we invite attention to the accepted principle that interrelated parts of a given transaction requiring a series of steps are to be treated as a whole, and immaterial differences in time disregarded. *Helvering v. Bashford*, 302 U.S. 454; *United Light & Power Co. v. Commissioner*, 105 F. (2d) 866 (C.C.A. 7th), certiorari denied, 308 U.S. 574; *Electrical Securities Corp. v. Commissioner*, 92 F. (2d) 593 (C.C.A. 2d). In this connection see also *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, where the Court disregarded an ostensible distribution to the stockholders in view of the fact the funds were not to be retained by the stockholders but were to be used to pay off corporate debts. In keeping with this principle, we think the apparent interval of a half hour

after the trustees informed the stockholders at 10:00 a. m., on October 4 that they had distributed the assets to them and prior to the time the new corporation accepted the offer to take the assets in payment for stock subscriptions should be ignored.

The trial court indicated that it was influenced by the fact that all but one of the stockholders affected paid income taxes upon the alleged liquidating dividends, treating them as income. (R. 28.) With due deference, we suggest that the court has fallen into error in predicating its decision on this circumstance. In our opinion it is necessary to distinguish between the facts and the self-serving action of the interested parties in reporting the receipt of the dividend which amounted only to a representation that they had received the amount of the distribution. For stockholders of a company to have paid a comparatively small sum individually in order that collectively they might avoid payment of a much larger amount of income and excess-profits taxes may have seemed good business. It was good business also to reorganize the company to accomplish a saving in excess-profits taxes, we have no doubt, and the Government has not challenged the right of the new corporation to its saving in excess-profits taxes by virtue of the larger declared value of its capital stock. We do challenge, however, the

proposition that a corporation may entirely omit the distribution of its assets to its stockholders preliminary to the transfer thereof to a new corporation and still be entitled to a dividends paid credit as if the distribution had been effected.

That there was never any intention of liquidating and abandoning the lucrative business of the taxpayer corporations is clear, and that the principal purpose in organizing a new company was to obtain a higher declared value upon the capital stock is also clear. (R. 85-86, 112-116, 147, 157.) A simple amendment to the company's charter would have accomplished an increase in the number of shares of stock and would have had the effect of capitalizing earned surplus. However, the accountant upon whose advice the interested parties relied, after consulting certain tax services concerning the proceedings to be employed in accomplishing the end desired, concluded that a new company should be organized. (R. 123-125.) We do not criticize the judgment of the tax adviser nor of the interested parties as it is quite possible that the only method of obtaining the higher declared value and thus to reduce excess-profits taxes was to organize a new company. We do not believe, however, that any theoretical distribution to the stockholders should be recognized in view of the absence of any instru-

ment sufficient to convey and assign the assets and interests in property to them individually. Parenthetically it may be pointed out that there is no evidence the amounts listed as the shares of the stockholders in the distribution in liquidation represented the real value of their respective shares in the assets since the allocation was based upon book values. (R. 127-129.) Admittedly the company's operations were highly profitable at the time so that we think it probable the book values constituted no true measure of the actual fair market value of the stockholder's respective interests in the enterprise. The desire to obtain a higher declared value lends added support to this conclusion.

If it be assumed for purposes of argument that the State of Washington levied excise taxes upon transfers of properties, assets and interests in property such as those here involved, it is pertinent to inquire if it could be successfully maintained that two transfer taxes would have been incurred under the facts of record when it is clearly established that the liquidating trustees made but the one assignment and that directly to the new corporation. We think it obvious the original company could not have been held liable for a transfer tax when it voted to liquidate since the corporation in dissolution continued to be the legal owner of its assets and property interests. Thus

a recognition of two separate transfers would require the recognition of a transfer from the liquidating trustees acting on behalf of the original corporation to themselves acting as agents for the individual stockholders. To recognize such a shifting of ownership without the execution of a bill of sale or other instrument would seem to open the door to grave abuses such as those the statute of frauds was intended to remedy.

In closely analogous situations involving sales of corporate properties by trustees in dissolution, or by the stockholders, taxation of the gains to the corporation has been repeatedly upheld. *Steinberger v. United States*, 81 F. (2d) 1008 (C.C.A. 9th); *Taylor Oil & Gas Co. v. Commissioner*, 47 F. (2d) 108 (C.C.A. 5th); *Embry Realty Corp. v. Glenn*, 116 F. (2d) 682 (C.C.A. 6th). Cf. *Helvering v. General Utilities & Operating Co.*, 74 F. (2d) 972 (C.C.A. 4th), reversed, 296 U. S. 200. In our opinion, there is no sound basis for distinguishing the general rule applicable under the facts here from the rule applied by the courts in the above cases.

A case with some superficial similarity to this proceeding should perhaps be noted, *Commissioner v. Falcon Co.*, 127 F. (2d) 277 (C.C.A. 5th.) Attention is

invited, however, to an important difference in that before the sale of the oil leases there involved, the taxpayer corporation actually distributed its interests in the leases to its stockholders, who thereupon sold such interests to the buyer. The court held in the absence of fraud that the profits were not taxable to the corporation, and that the sale was that of the individual stockholders. It should be noted too, that the *Falcon* case did not involve a reorganization, and the court observed specifically that the record showed no subterfuge or use of mere form to hide the substance of the real transaction. Cf. *Chisholm v. Commissioner*, 79 F. (2d) 14 (C.C.A. 2d), certiorari denied, 296 U. S. 641.

Before taking up the subject of reorganization, the applicability of Rule 52(a), Federal Rules of Civil Procedure, relative to the effect of the trial court's findings of fact should perhaps be mentioned. The court below found that the assets were "transferred to and vested in the plaintiffs as trustees for the stockholders and as liquidating trustees of the company." (R. 37.) In our opinion, this finding is ambiguous and the court indicates its confusion by the failure to distinguish between the office of the trustees as liquidators of the corporation and their purported office as agents for the individual stockholders.

It is arguable that the finding amounts only to a legal conclusion. We think that insofar as the court's findings construe the transactions in controversy as effecting a distribution to the stockholders, it is at most a mixed question of law and fact and there are no evidentiary facts to justify the conclusion that the distribution was effected. It is well settled that an ultimate finding of a trial court, contrary to the evidentiary findings or based upon a misapplication of law to the evidentiary findings, is not binding upon the appellate court. *Katz Underwear Co. v. United States*, 127 F. (2d) 965 (C.C.A. 3d); *United States v. Armature Rewinding Co.*, 124 F. (2d) 589 (C.C.A. 8th); *Fleming v. Palmer*, 123 F. (2d) 749 (C.C.A. 1st); and *Himmel Bros. Co. v. Serrick Corp.*, 122 F. (2d) 740 (C.C.A. 7th). Cf. *Equitable Life Assur. Soc. v. Irelan*, 123 F. (2d) 462 (C.C.A. 9th), holding that Rule 52(a) was intended to accord with the decisions on the scope of review by the appellate courts in federal equity practice.

It may not be amiss to comment that the Government stands ready to refund to the individual stockholders any overpayments due them by reason of reporting the liquidating dividends as income, and we note in this connection that the appellees have filed

timely claims to protect their interests in order that such individual overpayments may be recovered.

II.

ASSUMING THAT THE ALLEGED DISTRIBUTION TO THE STOCKHOLDERS IN LIQUIDATION WAS EFFECTED IT SHOULD BE DISREGARDED AS AN EXTRANEOUS AND UNNECESSARY STEP IN A PLAN OF REORGANIZATION

Some of the discussion under Point I is relevant to our argument here, particularly that portion wherein it was urged that the purported distribution in liquidation should be ignored, even if the Court were persuaded such distribution was momentarily accomplished prior to the retransfer of the assets to the new company. We now wish to amplify this contention and to carry it to its logical conclusion, namely, that the steps taken were interrelated parts of a single indivisible plan of corporate reorganization, thus justifying the Commissioner's refusal to recognize the alleged distribution of the liquidating dividend.

We have heretofore pointed out that notwithstanding recitals in the corporate minute books, the steps taken to dissolve the taxpayer corporation and to organize its successor to continue the business were obviously carried out at approximately the same time

as interrelated parts of a single plan and not at different times as a series of separate and unrelated transactions. Moreover, the trial court has specifically found it to be a fact that the sole purpose of the directors was to correct the situation which had arisen by reason of the fact the corporation was paying excess-profits taxes in an amount larger than the company's situation required due to the declared value of the capital stock being too low. (R. 37.) The evidence clearly supports this finding as to the underlying purpose for the dissolution of the original company and for the organization of its successor. In all the testimony we find no hint of any intention or desire on the part of a single stockholder to liquidate and abandon the company's profitable business.

Under such circumstances we believe that substance and not form should control for purposes of taxation and that both from the standpoint of the new corporation and from the standpoint of the stockholders the transfer should be treated as one made directly from the taxpayer to its successor. To charge the stockholders with the receipt of income based upon bookkeeping entries or based upon a transitory shifting of the company's assets to them would seem to be a highly technical application of the taxing statutes. This reasoning is supported,

in our opinion, by the great weight of authority: *Gregory v. Helvering*, 293 U.S. 465; *Minnesota Tea Co. v. Commissioner*, 302 U.S. 609. Cf. *Higgins v. Smith*, 308 U.S. 473; *Griffiths v. Commissioner*, 308 U. S. 355; *Lucas v. Earl*, 281 U.S. 111.

The court below held that the continuity of interest requisite for the establishment of a reorganization did not exist. (R. 41.) We fail to see how a greater continuity of interest is possible since all stockholders continued in the new corporation without any change whatever in their proportionate holdings of capital stock.

CONCLUSION

The taxpayer's assets were never in fact distributed among the stockholders as a liquidating dividend. Moreover, even if such distribution had been accomplished, this would have constituted but one of a series of steps in a plan of reorganization under which it was contemplated that the assets and interests in property would be immediately passed on to the new corporation organized for the sole purpose of continuing the business. Under these circumstances the alleged distribution, being momentary and unnecessary as well, should be disregarded. Hence the dividends paid credit for the alleged distribution was

properly disallowed by the Commissioner. The decision below is erroneous. The case should be remanded with instructions to modify the judgment by eliminating therefrom that part of the recovery attributable to this issue.

Respectfully submitted,

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No. 10233

6

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

THOR W. HENRICKSEN, Acting Collector of Internal Revenue, *Appellant*,

vs.

W BRAICKS and J. G. MOLZ, Liquidating Trustees of Pommerelle Company, Inc., a Corporation, *Appellees*.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION
HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF OF APPELLEES

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THE ARGUS PRESS, SEATTLE

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TABLE OF CONTENTS

TABLE OF CASES

TEXTBOOKS

STATUTES AND REGULATIONS

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UNITED STATES CIRCUIT COURT OF APPEALS
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UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION
HONORABLE LEWIS B. SCHWELLENBACH, *Judge*

BRIEF OF APPELLEES

STATEMENT

In order to properly evaluate appellant's position and argument upon this appeal, it is necessary to know something more than is contained in his statement about the background and history of the case in the lower court. While not entirely obvious, a study of the record, particularly the commissioner's assessment letter and the trial court's decision, together with admissions in the appellant's brief, discloses that the controversy now presents quite a different aspect from that decided by the trial court. The case arose in this way:

The taxpayer, Pommerelle Company, Inc. (which we shall hereafter call the old company) claimed a

dividend paid credit upon its tax return for 1937, on account of a distribution in liquidation under Sec. 27 (f) I.R.C. The commissioner disallowed the credit, and assessed the additional tax involved in this proceeding on the ground that the distribution was a non-taxable dividend and therefore not an allowable credit. This holding was based upon the theory that the stock in the Pommerelle Company (which we shall hereafter call the new company) was issued to the stockholders of the old company in connection with a transaction coming under the provisions of Sec. 112 (b) of the Revenue Act of 1936, dealing with tax deferred exchanges, and was not taxable to them, and that therefore the transaction came within Sec. 27 (h), disallowing a credit for a nontaxable distribution, which it was held took precedence over Sec. 27 (f) allowing a credit for a distribution in liquidation.

In support of the action in the trial court appellees made two claims:

First, that Sec. 27 (f) should be applied in preference to Sec. 27(h), relying upon the interpretation placed upon such section by the Circuit Courts of Appeals of the 2nd Circuit in *Comm. v. Kay Mfg. Corp.*, 122 F.(2d) 442, 1941-2 U.S.T.C. §9635 and the 4th Circuit in *Helvering v. Credit Alliance Corp.*, 122 F. (2d) 361, 1941-2 U.S.T.C. §9639 and by the Board of Tax Appeals in a large number of similar cases, as opposed to the commissioner's theory which was supported by the opinion of the Circuit Court of Appeals of the 5th Circuit in the case of *Centennial Oil Co. v. Thomas*, 109 F.(2d) 359, 40-1 U.S.T.C. §9197. Secondly, appellees urged that even if their first contention

was incorrect, the commissioner was still wrong in classifying the transaction as a nontaxable distribution or exchange.

The trial court held with the appellees upon both of their contentions. It was his opinion and holding that the old company liquidated by turning over its assets to designated trustees, who, by arrangement with the stockholders, held and dealt with such assets as trustees for the individual stockholders; that proportionate undivided interests in liquidation were assigned and set over to the stockholders, each of whom was then free to deal with his interest as he saw fit; and that thereafter the stockholders converted their undivided interests in the property into shares of the new corporation for which they had previously subscribed; that all parties recognized the freedom of the stockholders to go into or stay out of the new company and that it did not constitute a tax free reorganization or transaction (R. 24 to 29). In addition, the court held that even if this conclusion was wrong, there was nevertheless a distribution in liquidation under the provisions of Sec. 27 (f) of the Revenue Act of 1936, which should be applied, rather than the provisions of 27 (h), and that the company was entitled to the credit in any event under the provisions of that section (R. 30 to 34).

Appellant's statement of points and outline of argument upon this appeal (App. Br. 13, 15) are directed entirely toward the contention that the old company did not distribute its physical assets to its stockholders, but acting through the trustees in liquidation assigned them to the new company, which in

return issued its stock to the stockholders of the old. Presumably, although he does not specifically claim it, he considers this a transaction coming within the provisions of 112 (b). His argument is solely an effort to refute the court's holding that there was a distribution by the old company of the physical assets to its stockholders. But this is only a part of the picture, and it fails to recognize that even if appellant were right in his contention as to the transfer of the assets, there was still a distribution in liquidation, giving rise to dividend credit. It is undeniable that a liquidation of the old company did occur (App. Br. p. 8). It began with the adoption of the resolution and it ended not later, in any event, than the receipt by the stockholders of stock in the new company. We maintain and the court found that the liquidation occurred by transfer of the physical assets to the stockholders, acting through the liquidating trustees, who then used their undivided shares to pay for their stock in the new company. Appellant contends, on the other hand, that the old company acting through the liquidating trustees transferred its assets to the new company, thereby becoming, in effect, a stockholder of the new company, but causing the stock to be issued directly to the individual shareholders.

Either way, there was a liquidation of the old company, and the allowance of the dividend credit does not depend simply on whether the course followed was that claimed by the appellees and found by the trial court or was as contended by the appellant. Even if viewed as appellant contends, the dividend credit would still be allowable under Sec. 27(f). The appellant wholly ignores this phase of the matter.

ARGUMENT

EVEN IF THE TRANSACTION IS REGARDED, AS APPELLANT CONTENDS, AS A TRANSFER OF ASSETS DIRECTLY TO THE NEW COMPANY, THERE WAS STILL A LIQUIDATION OF THE OLD COMPANY, ENTITLING IT TO A DIVIDEND PAID CREDIT.

For the sake of the argument on this point, we shall accept appellant's contention that the trustees did not represent the stockholders and that in effect the physical assets passed directly from the old company to the new one. If that was true, then that transaction in itself was not a liquidation but an exchange, which, we will assume, was nontaxable under Sec. 112 (b) (4) I.R.C. The old company then became entitled to the stock of the new. This stock, however, it caused to be issued directly to the individual stockholders, and this action effected the liquidation which had previously been authorized. If we accept appellant's contention, then instead of a distribution of undivided interests in physical assets in kind, the liquidation was accomplished by a distribution of the stock of the new company. Since Sec. 27 (f), allowing a dividend credit for amounts distributed in liquidation, controls over Sec. 27 (h), it is immaterial whether the liquidation was accomplished in the manner found by the court or in the manner found by the appellees. It occurred in one way or the other and whichever way it was, the credit would be allowable just the same.

At the time the case was submitted to the lower court the question of application of Sec. 27 (f) was a debatable one and appellant strenuously maintained

that, in view of the provisions of 27 (h), no credit would be allowed if the distribution was in connection with a nontaxable exchange. On April 27, 1942, however, the Supreme Court decided *Helvering v. Credit Alliance Corp.*, 316 U.S. 107, 62 S.Ct. 989, 42-1 U.S. T.C. §9440, in which it affirmed the decision of the 4th Circuit that sub-section (f) takes precedence over sub-section (h) and allows a credit for a distribution in liquidation, regardless of whether or not there is involved a nontaxable distribution.[1]

It follows, therefore, that if the old company did make a distribution in liquidation, it was entitled to the credit under Sec. 27 (f). Even if the transfer of physical assets was made as appellant contends, direct from the old company to the new, and even if this constituted a tax free exchange (which we do not concede) such considerations are not controlling, because there followed a distribution in liquidation of the stock so received by the old company to its stockholders (accomplished by issuing such stock directly from the new company to them), and such a distribution in liquidation was a taxable transaction to the stockholders under the provisions of 115 (c) I.R.C., and they so treated it. While appellant argues that liquidation did not occur in the manner and form as found by the trial court, he does not maintain that the old company did not liquidate, and the only difference would be between distributing physical assets and

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[1]For a discussion of liquidation distributions, and citation of other court and Board cases on the subject, see 1943 C.C.H. Vol. 1, at pages 2208-11.

stock. In either case, however, it would be a distribution in liquidation and the credit was properly allowed.

THE OLD COMPANY DISTRIBUTED ITS ASSETS IN LIQUIDATION TO ITS STOCKHOLDERS WHO SUBSEQUENTLY AND WITHOUT PREVIOUS OBLIGATION EXCHANGED THEM FOR STOCK IN THE NEW COMPANY.

While we accepted appellant's version of the transaction in the foregoing discussion, feeling that it could not affect the result, we did not mean in any way to concede the correctness thereof but feel that the findings and conclusions of the trial court are amply supported by the record. Indeed, the appellant has taken no exception and assigned no error upon the court's findings of fact, either in his statement of points (R.208; App. Br. 13) or in his argument.

While it is urged that the step taken was for the purpose of lessening taxes, it is admitted that "the government has not challenged the right of the new corporation to its saving in excess-profits taxes by virtue of the larger declared value of its capital stock" (App. Br. 21), and no authority need be cited to the oft repeated statement that no condemnation attaches to the use of lawful means to minimize the burden of taxes (101 A.L.R. 204). Moreover, as the trial court pointed out, that purpose was not directed at the tax here involved, which was only incidentally affected (R.19), and the true purpose of the undistributed profits tax was recognized and effectuated in the steps taken by returning the income upon dis-

tribution to stockholders and paying the tax thereon. As the court said "it must, therefore, be realized that the transaction under inspection here fully complied with the legislative purpose for the raising of revenue and that the mechanism used in the transaction was not devised with an ulterior purpose" (R.20).

The trial court has so well covered both the factual and the legal situation and arguments in support of the appellees' position in his exhaustive opinion (R. 15-34) that little need be added except a few comments directed particularly at the argument advanced in appellant's brief.

The record shows that the old company adopted its resolution for liquidation on September 30, 1937 (R.88). On October 4, 1937, the final meeting of the stockholders was held, at which the liquidating trustees reported that they had liquidated its assets and affairs by distributing the same to its stockholders in undivided portions, and the stockholders voted unanimously to accept their proportionate shares in liquidation (R.89, 90). It is clearly apparent that all parties intended and assumed that a distribution of undivided interests to the respective stockholders was effected either by the resolution or by the action of the trustees, or both (R. 149, 150). Subsequent to this time, although on the same day, the stockholders offered to exchange their undivided ownerships and interests in such assets in payment of stock in the new corporation, for which they had previously subscribed for cash. Appellant questions the reliability of this record, claiming that this offer was dated September 30th (App. Br. 10) and arguing that it therefore

could not contain a balance sheet of October 4th (App. Br. 19). In making this criticism, the appellant has apparently misread the record containing the exhibits. Beginning at page 100 of the transcript, the date of September 28th clearly relates to the preceding oath of office and not to the subscription for stock, as claimed by appellant (Br. 9, 19). The next date, September 30, 1937, appearing at the middle of page 101, should be read as applicable to the subscription to stock of the new company. The offer to exchange property for stock is not specifically dated, but since it carries a statement of assets and liabilities, bearing date of October 4th, and since it is obviously the offer referred to on page 106 as dated October 4th, such facts would seem to establish that as its date and that the criticism is unjustified. While the trial court's findings did not specifically set forth the dates, his opinion establishes the sequence of events as being a liquidation through transfer to the liquidating trustees as agents of the stockholders, followed by the latter's offer to transfer such interests to the new company in payment for its stock (R. 15, 16).

The obvious purpose of this criticism is to impugn the record showing an interval elapsing after the distribution of the old company's assets before the surrender of them to the new company. This break in ownership, however, does not depend only on the minutes but is well supported by the testimony of several witnesses to the effect that each stockholder was advised upon the liquidation of the old company that he was free to either stay out of, or go into, the new company as he chose, and arrangements were made

to take over the interests of any of the stockholders who might prefer not to go on. This was not merely an internal understanding but involved going to the company's bankers and arranging for the necessary funds for that purpose (R. 16, 38, 54, 61, 66, 68, 70, 123, 124, 132, 143, 144, 150, 151).

It is appellant's contention that the old company continued to be the legal owner of its properties until they were turned over to the new company pursuant to the offer of the individual stockholders, so that title went directly from the old company to the new (App. Br. 16). It is urged that this was so because no formal instruments were executed conveying the assets to the stockholders (App. Br. 3, 18). That, however, would have been a cumbersome procedure, since the interests were necessarily indivisible. The trial court considered that the assets went in undivided interests to the shareholders of the old company and were held for them in trust by the trustees in liquidation (R. 15, 24, 37, 38). This, we submit, is in accord with Washington law. While there is no case directly upon the point, the statutes governing liquidation recognize that upon the adoption of the resolution the corporation itself ceases to function and the assets are subject to possession and distribution by the trustees, to be applied first to the payment of debts and then to the interests of the stockholders. The adoption of such resolution necessarily transferred to the designated trustees either the legal title to or at least possession of the property of the corporation, since the statute vests them with the power to collect amounts due, sell any and all assets and pay

the debts (Rem. Rev. Stat. §3803-52), to compromise and settle claims (§3803-54), and directs that any balance remaining after paying the corporate debts be paid over to the shareholders (§3803-52(2)). When the proceedings for dissolution are begun, the right of the corporation to function in the usual manner, and the authority and duties of the directors and officers, come to an end (§3803-56(2a)).

Remington's Revised Statutes §3836-15 provides that in the event of dissolution of any corporation for the nonpayment of fees, either by court action or otherwise, the trustees shall hold the title to the corporate property for the benefit of its creditors and stockholders. Prior to the adoption of the Uniform Business Corporation Act embodying the above section, Remington's Revised Statutes §3833 provided that the trustees at the time of the dissolution should be trustees for the creditors and stockholders of the corporation dissolved with power to divide among the stockholders the property and money remaining after payment of debts. While this section was repealed by §3803-62a, nevertheless there is nothing in the new statute which is inconsistent with the prior one to the effect that the trustees are trustees for the stockholders and it would seem that that is still a fair interpretation of the term. That this is the general rule as borne out by 16 Fletcher Cyc. Corp. (Perm. Ed.) §8195, where it is stated that upon the dissolution of the corporation, the corporate entity ceases, and the property and funds of the corporation are vested in the trustees for the stockholders. Where, for example, the trustees misappropriate corporate

funds, it is held that the remedy is one for money had and received to the use of the stockholders. *Denman v. Richardson* (W.D. Wash.) 284 F. 592, affirmed by this court, 292 Fed. 19.

Under the above statutory provisions, as well as the trust fund doctrine respecting corporate assets applicable in the state of Washington, the trustees necessarily took and held the property, first for the satisfaction of debts, and secondly for the equitable benefit of and distribution to the stockholders.

"The general effect of statutes designating or providing for the appointment of trustees for dissolved corporations is to constitute the property and rights of the dissolved corporation a trust fund to be administered by the trustees for the purposes specified by the legislature. The doctrine generally accepted with little dissent is that statutes of the kind under review vest the legal title to the corporate property in the trustees." 13 Am. Jur. Corporations §1359. See also annotations 97 A.L.R. 486; 47 A.L.R. 1528-29, 1540; Fletcher Cyc. Corp. Vol. 16 §§8174, 8195.

Indeed the Supreme Court of Washington indicates that it goes even further than that by its comment in *Cohen v. L. & G. Investment Co.*, 186 Wash. 308, referring to "the well established rule that, upon dissolution, the property of a corporation passes to the stockholders, subject to the corporate liabilities." See also *Golden Rule Trading Co.* (D.C. Wash.) 17 F. Supp. 21.

However that may be, it is well established that the trustees hold no more than a legal title in trust for the stockholders as the beneficial owners, subject only to

the debts. The recognition of the stockholders' interest by the accounting of the trustees and acceptance of the stockholders (R. 90) would seem sufficient to fix or accomplish the status of an actual distribution.

The failure to pay the debts would not prevent the distribution in liquidation as claimed by the appellant (Br. 18). The assets were dealt with subject to the liabilities (R. 102) which by the terms of the offer the new company was to assume and agree to pay, and by its acceptance of such offer it must be deemed to have assumed such obligations (R. 106). "Stockholders actually receiving the assets of their corporation on its dissolution in virtue of their stock are held to receive a present liquidating dividend though they may not pay the corporate debts and fully administer the assets until later. *Hellmich v. Hellman*, 276 U.S. 233, 48 S. Ct. 244, 72 L. ed. 544, 56 A.L.R. 379; *Jemison v. Commissioner* (C.C.A.) 45 F.(2d) 4; *Wells Fargo Bank v. Blair, supra.*" *Snead, Collector v. Elmore* (C.C.A. 5) 59 F.(2d) 312, 11 A.F.T.R. 484.

A similar situation was involved in the appeal of *Harbor Holding Company of Nevada et al.*, Memo dec. Docket Nos. 106027-106031, entered November 10, 1942, where the board said:

> "Respondent argues that petitioner had a continued existence, *de facto*, and that Henderson was acting as *its* liquidating trustee, rather than as a trustee for the former stockholders, because of the existence of unpaid liabilities. Under all of the circumstances, respondent takes the view that since petitioner's debts were not paid prior to the liquidating distribution, the Van Camp stock remained vested in petitioner after the dissolu-

tion, through a 'liquidating trustee.' In our opinion this phase of the situation does not militate against petitioner. Under ordinary circumstances there is no impediment to a corporation's selling or distributing its assets to others in consideration for their assuming the corporation's liabilities. It is a question of fact of what is done. The existence of debts does not prevent or defer the vesting of title to assets distributed to stockholders. This was pointed out in *Snead v. Elmore*, 59 F.(2d) 312, 315. * * *

"Here the stockholders actually received petitioner's assets on its dissolution. They received the assets unconditionally. A corporation may distribute its assets in complete liquidation without first paying all of its debts." (p. 35, 36)

This record, plus the information returns made in connection with the liquidation (R. 81) and the detailed statements and instructions to the stockholders regarding profit and return of income on distribution and the payment of tax thereon by the stockholders (R. 56) all indicate and support the court's finding of an actual distribution in liquidation. Such liquidation or distribution is a question of fact upon which the court has made a specific finding supported by substantial evidence which should not be disturbed.

The cases discussed by appellant at page 24 of his brief involving liquidations designed to shift income by converting a sale by the corporation into a sale by individual stockholders, present an entirely different principle and depend primarily upon the peculiar facts of each case and seem not to require comment. They are not inconsistent with the decision here. They hold

that if the distributees are obligated to complete a bargain begun by the corporation, they are acting merely as the corporation's agent. If not, and if they are free to choose between making a sale, or not, then they are acting for themselves. *Chisholm v. Comm.* 79 F. (2d) 14, 101 A.L.R. 200, cert. den. 296 U.S. 641.

Upon this phase of the case, the governing considerations are primarily of a factual nature and being supported by substantial evidence are not subject to being disturbed, particularly in the absence of any exceptions thereto.

It seems to be contended by appellant and we have assumed, without conceding, that the transfer of physical assets to the new company for which stock was issued by the latter directly to the stockholders of the old company was a nontaxable transaction under Sec. 112(b) of the Revenue Act of 1936.[2] While we think

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[2]SEC. 112 RECOGNITION OF GAIN OR LOSS. (Revenue Act of 1936.)

(b) Exchanges solely in kind.

(1) *Property held for productive use or investment.* No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) *Stock for stock of same corporation.* No gain or loss shall be recognized if common stock in a corporatin is exchanged solely for common stock in the

that is immaterial, since there was a liquidation taxable under Sec. 115(c) I.R.C., nevertheless, if it is relevant, we think it is a mistaken conclusion or assumption.

Section 112(a) provides that upon the sale or ex-

---

same corporation, or if preferred stock in a corporation is exchange solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.* No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of corporation.* No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.* No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(6) *Property received by corporation on complete liquidation of another.* No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. * * *

change of property the gain shall be recognized except as thereinafter provided. Section (b) deals with "exchanges solely in kind" and covers six specific situations where gain is not recognized. The first relates to property held for productive use in trade or business, or for investment, which is exchanged solely for property of a like kind; the second, to exchange of common stock solely for common stock in the *same* corporation or preferred stock solely for preferred stock in the *same* corporation; the third, to exchange of stock or securities in a corporation solely for stock or securities in such corporation or in another corporation, a party to a reorganization, and in pursuance of a plan of reorganization; the fourth covers exchange of property by one corporation solely for stock or securities of another corporation, a party to a reorganization, and pursuant to a plan of reorganization; the fifth covers transfer of property to a corporation by one or more persons solely in exchange for stock or securities in such corporation; and the sixth covers receipt by a corporation of property distributed in complete liquidation of another corporation.

However, none of these sections is applicable to the present situation in the sense for which appellant contends. It did not involve an exchange of property held for productive use in trade or business or for investment for other property of a like kind. It was not an exchange of common or preferred stock for similar stock in the same corporation. It was not an exchange of stock of one corporation solely for stock in another corporation as provided in (b) (3). The nearest to being applicable might be (b) (4) covering an exchange

of property for stock or securities of another corporation, but there are several reasons why this section does not apply.

In the first place, the old company did not exchange its property for stock of the new company. That requirement would only be met by issuing the stock in the new corporation to the taxpayer company and not to the individual stockholders as was actually done.

In the next place, it must be done pursuant to a "plan of reorganization." Since there is no such plan the taxpayer would not be in a position to claim the benefit of the statute and, conversely, it could not be enforced against the taxpayer. Regulations 94, Articles 112(g)(2) and 112(g)(3). *Appeal of A. T. Evans*, 30 B.T.A. 746 at 752.

Finally, this subsection requires an exchange of property by one corporation *solely* for stock of another corporation. Here there was an additional consideration—an assumption of liabilities by the new company. For these reasons therefore—no exchange between one corporation and another, no plan of reorganization, and a substantial consideration other than receipt of stock—the steps taken fail to accord with the requirements of (b)(4).

The next subdivision applies only to transfers from one or more persons to a corporation in exchange for stock and is the familiar case of organization of a corporation and payment for its stock by turning in property. It is applicable so far as the last step in the transaction is concerned, namely, the formation of the new company and transfer to it by the individuals of

their interest in the property received in liquidation for the stock of the new company. It does not, however, by its terms apply to the transaction to which the appellant seeks to apply it, namely, the transfer by the old company of its property upon cancellation and surrender of its stock.

The sixth subdivision is obviously inapplicable because it relates only to liquidation of a controlled subsidiary corporation.

Even if the transaction satisfied the requirements of any of these sections in its technical aspects, it would still fail to be a tax free reorganization because of a lack of continuity of interest, in that the stockholders definitely received their respective undivided interests on liquidation and were free to retain the same and not go into the new corporation if they wished to do so. Had they bound themselves to turn in their property to the new organization the situation might be somewhat different, although even then it would fail to satisfy the technical reorganization requirements. But they were not obligated to do so nor was the new corporation obligated to accept payment of stock through the transfer of their property interests. Their subscriptions were in dollars and the new corporation could have insisted on the payment of dollars and not property had it seen fit to do so.

With regard to step transactions generally, see Paul and Mertens, Law of Federal Income Taxation, Vol. 2, p. 234, §17.110 and p. 235, §17.111, particularly examples (7), (11) and (14).

Another reason why the disallowance of the credit

was wrong is found in the regulations, under Section 27, respecting distributions in liquidation. In dealing with distributions which diminish earnings or profits, Section 19.27(g)-1 of Regulations 103 (1943 C.C.H. §372) corresponding with Article 27(f)-1 of Regulations 94, issued under the 1936 Act, provides that an allowance for dividends paid may be included in the basic surtax credit for the amount actually involved in such distribution as is properly chargeable to the earnings or profits accumulated after February 28, 1913, even though the method of taxation of the distribution is that ordinarily employed with respect to gain or loss realized and recognized upon an exchange rather than that employed with respect to a taxable dividend, but that this does not apply to a transaction which results in a transfer of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the law as earnings or profits derived from its own operations. In discussing the credit in respect of earnings or profits transferred under certain tax-free transactions, the Regulations provide:

> "If, as a result of one or more transactions described in Section 112, a corporation's earnings or profits accumulated after February 28, 1913, and its undistributed earnings or profits of the taxable year shall have become the earnings or profits of another corporation subject to distribution as dividends by such other corporation, any dividend paid by the transferee corporation during that portion of the transferor's taxable year

> subsequent to the consummation of such tax free transaction may, subject to the provisions of Section 115, be apportioned and allocated to the transferor as a distribution of such earnings or profits of the transferor." Reg. 103 §19.27(g)-1(c) 1943 C.C.H. §372.

In other words, under these rulings the credit is denied to the transferor in the case of such a transfer where the accumulated earnings or profits are available for distribution as dividends by the transferee. But that condition would not apply in this case because the assets transferred to the new company were received and applied as payment for its capital stock and could not constiute surplus or a fund from which dividends could be paid. Rem. Rev. Stat. §3803-24. See *Appeal of Reed Drug Company*, 44 B.T.A. No. 92.

While we repeat again that we do not believe that the question of whether the transfer of assets to and the issuance of stock by the new corporation constituted a tax free exchange under Sec. 112 (b) I.R.C. is material, we have discussed it because of appellant's insistence on the point and because consideration of the provisions of the section as applied to the facts of this case shows that even this argument is not well founded. The group of decisions of the Supreme Court of February 2, 1942, *Helvering v. Alabama Asphaltic Corp.*, 315 U.S. 179; *Helvering v. Palm Springs Holding Corp.*, 315 U.S. 185; *Helvering v. Marlborough House, Inc.*, 315 U.S. 189; *Helvering v. Southwest Consolidated Corp.*, 315 U.S. 194, decided while this case was under consideration and discussed by the trial court in his memorandum,

shows that the statute must cover literally and exactly the situation to which it is sought to apply it in order to produce a tax free or deferred result. Cf. *C. D. Johnson Lumber Co.* 47 B.T.A. 119.

The fact that the stockholders may have intended to go into the new company, in the absence of any obligation requiring them to convey their undivided interests to it, would not affect the situation. As was said in the appeal of *Harbor Holding Company* above cited:

> "When petitioner made the liquidating distribution of the Van Camp stock, each distributee was free to retain the stock, was free not to sell to the Phister group. As the matter stood on December 29, 1938, the offer of the Phister group had not been accepted, and, although it appears at that time the Phister group intended to buy the Van Camp stock and the individual distributees, except the Bonynges, intended to sell their respective shares, there remained still the interval within which everyone could have changed their minds. See *Estate of C. William Meinecke*, 47 B.T.A. 634, 639.
>
> "Under the above facts, it is concluded that certain former stockholders of petitioner, acting in their own right, voluntarily and without any obligation having been imposed upon them by petitioner, sold Van Camp stock to which they had title on December 30, 1938. It is not material that they consented to petitioner's dissolution in anticipation of their selling the property thereafter, which they would receive upon dissolution. It certainly was in the minds of the four stockholders of the Falcon Company that they anticipated selling the property they would receive in partial liquidation of Falcon at the

time they consented to the partial liquidation. On this point the facts here do not take this case outside the rule of the *Falcon* case."

CONCLUSION

To sum up, the position of the appellees is as follows:

The trial court was correct in determining that the trustees took and held the physical assets of the old company in trust for the stockholders and that there was a distribution of such assets to the stockholders followed by a transfer by or on behalf of the stockholders to the new corporation in exchange for its stock. There was therefore a liquidation of the old company and distribution of its assets wholly independent of the new company, thus supporting the dividend credit under Sec. 27 (f).

Even if the transaction amounted to a transfer of assets by the old company in exchange for issuance of stock to the stockholders of the old company, such transaction did not constitute a nontaxable distribution.

Finally, and in any event, whether the receipt of assets by the new company and issuance of its stock constituted a nontaxable transaction or not, there was a distribution in liquidation by the old company, for which it is entitled to a dividend credit under the plain terms of Sec. 27 (f). *Helvering v. Credit Alliance Corp., supra.*

Respectfully submitted,

JONES & BRONSON
H. B. JONES
Attorneys for Appellees.

No. 10243

7

United States
Circuit Court of Appeals
For the Ninth Circuit.

UNITED STATES OF AMERICA,

Appellant,

vs.

WESTERN SHORE LUMBER COMPANY,
a corporation,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division

ROTARY COLORPRINT, 590 FOLSOM ST., SAN FRANCISCO 60-10-13-42

No. 10243

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UNITED STATES OF AMERICA,

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

Index Page

Index Page

Index Page

Index Page

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San Francisco, California

Attorneys for Defendant and Appellant.

In the District Court of the United States in and for the Northern District of California, Southern Division

No. 21438L

WESTERN SHORE LUMBER COMPANY, a corporation,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

To the Honorable, the Judges of the United States District Court for the Northern District of California:

Plaintiff Western Shore Lumber Company complains of defendant United States of America and alleges that:

I.

Plaintiff is and at all times herein mentioned has been a corporation duly organized and existing under and by virtue of the laws of the State of California. The prin- [1*] cipal place of business and the residence of plaintiff is 403 Merchants Exchange Building, San Francisco, California.

II.

This is an action to recover federal internal revenue taxes in the nature of capital stock taxes for

*Page numbering appearing at foot of page of original certified Transcript of Record.

the years ending June 30, 1933, June 30, 1934, June 30, 1935, and June 30, 1936, respectively, which have been erroneously and illegally assessed against and collected from the plaintiff. The action arises under the statutes of the United States providing for internal revenue and in particular Section 215 of the National Industrial Recovery Act, Section 701 of the Revenue Act of 1934, and Section 105 of the Revenue Act of 1935, and is brought under the provisions of Title 28, Section 41, Paragraph 20, of the United States Code.

III.

All returns, payments, claims for refund and other acts prerequisite to this action have been duly made and filed by plaintiff within the time required by law and the plaintiff is entitled by reason of the denial of its claims for refund to institute this action.

The dates of the filing by plaintiff of its returns under the capital stock tax and of the payment of tax thereunder and the amount of tax so paid are as follows:

Year Ending	Date Return Filed and Tax Paid	Amount of Tax Paid
June 30, 1933	August 29, 1933	$1,250.00
June 30, 1934	August 31, 1934	25.00
June 30, 1935	July 31, 1935	24.00
June 30, 1936	September 18, 1936	1,000.00

[2]

Copies of the returns of plaintiff for the above years are hereunto annexed, marked Exhibits A-1

to A-4, inclusive, and by this reference made a part hereof.

On August 28, 1937, plaintiff filed with the Collector of Internal Revenue at San Francisco, California, its claims for refund of the amounts paid as hereinabove set forth as capital stock tax. Copies of said claims for refund are attached to this complaint, marked Exhibits B-1 to B-4, inclusive, and by this reference made a part hereof.

On January 31, 1938, plaintiff received by registered mail notification from the Commissioner of Internal Revenue, dated January 26, 1938, that the Commissioner rejected the claims for refund filed by the plaintiff. A copy of said notification of rejection of claim for refund is attached hereto, marked Exhibit C, and by this reference made a part hereof.

IV.

The action of the Commissioner of Internal Revenue in rejecting the claims of plaintiff for refund of the amounts paid as capital stock tax was erroneous for the reason that plaintiff was not at any time during the period from July 1, 1932 to June 30, 1936, carrying on or doing business. The sole function of plaintiff during said period consisted of the holding of its assets until such time as the same might be satisfactorily liquidated and of the distributing of proceeds currently received on account of such assets.

Prior to 1922 plaintiff carried on operations as a timber company but in that year a mill which

had been erected in 1917 was shut down and has not since been operated. In 1922 plaintiff reduced its activities to the mere owning and [3] holding of the timber properties then vested in it and since that date its sole activities have been directed to caring for such timber properties until the same can be liquidated in an orderly manner. The only receipts of plaintiff for the period from July 1, 1932 to June 30, 1936 were interest on bank deposits and receipts under a stumpage contract under which the plaintiff liquidated certain of its timber holdings and further receipts in the total amount of $208.08 derived from the sale of equipment and junk. A copy of the stumpage contract under which plaintiff derived its cash receipts is attached to and forms a part of Exhibit B-1 hereto and reference is made to said exhibit for its terms and provisions.

During the period from July 1, 1932 to June 30, 1936, plaintiff had no regular employees other than a secretary and a caretaker and has employed no other person or persons other than the occasional temporary hiring of laborers to render fire protection service for the protection of the timber stands owned by plaintiff. During said period plaintiff performed no corporate acts other than the payment of taxes and the management of affairs purely internal in character necessary to the preservation of its charter. A copy of plaintiff's Articles of Incorporation is attached hereto, marked Exhibit D, and by this reference made a part hereof. Copies of the minutes of all meetings of the Board of Direc-

tors of plaintiff during the period from July 1, 1932 to June 30, 1936, are attached to Exhibits B-1 to B-4, inclusive, and reference is made thereto for the matters contained in said minutes.

Plaintiff acquired no property during the period herein mentioned and paid no dividends to any stockholder. The only property sold by plaintiff during said period was the timber [4] sold pursuant to the stumpage contract above mentioned and the equipment and junk which was sold for $208.08. None of the corporate functions set forth in plaintiff's Articles of Incorporation as business purposes have been performed during said period and in this connection plaintiff alleges that it is not necessary under the laws of the State of California to amend the Articles of Incorporation when a corporation ceases to carry on operations.

During the period in question the timber holdings of the plaintiff consisted of approximately 12,500 acres of timber land in San Mateo County, California, and approximately 550 acres of timber land in Santa Cruz County, California. Plaintiff during said period owned no property other than the said timber lands, certain small buildings located thereon, and cash deposited in banks.

Plaintiff was not at any time herein involved affiliated with any other corporation nor did it own any stock in any other corporation.

V.

Plaintiff has carried on no business since 1922. In this respect plaintiff alleges that it filed claims for

refund of capital stock taxes paid for the years 1923 to 1928, inclusive, which refund claims were allowed by the Bureau of Internal Revenue and paid to plaintiff. The amounts paid as capital stock tax for the period herein involved were paid through inadvertence and accordingly plaintiff filed with the Commissioner of Internal Revenue its claim for refund of the taxes paid together with interest thereon, which claims were rejected by the Commissioner as hereinbefore set forth. [5] Plaintiff has not received by way of cash repayment or in the form of any credit the amount of taxes so paid or any part thereof and the Commissioner of Internal Revenue has at all times retained the amount of said taxes and all thereof.

VI.

Upon the facts recited herein plaintiff alleges that the defendant has collected and retained from it erroneously and without authority of law and contrary to the provisions of the laws of the United States relating to Internal Revenue the sum of Two Thousand Two Hundred Ninety-Nine Dollars ($2,299.00) comprising capital stock taxes paid as hereinbefore set forth, and plaintiff further alleges that it is justly entitled to the amount of taxes so paid together with interest thereon at the legal rate from the respective dates of payment.

Wherefore, plaintiff seeks judgment for the sum of Two Thousand Two Hundred Ninety-Nine Dollars ($2,299.00) together with interest thereon at

the legal rate from the respective dates of payment thereof, for such costs as may be allowed under Title 28, Section 258, of the United States Code, and for such other and further relief as the court may deem meet and proper in the premises.

A. CRAWFORD GREENE
HENRY D. COSTIGAN
ROBERT MINGE BROWN
McCUTCHEN, OLNEY,
MANNON & GREENE
Attorneys for Plaintiff
Office and Post Office Address:
1500 Balfour Building
San Francisco, California. [6]

(Duly Verified.) [7]

EXHIBIT A-1

(Copy)

Form 707
Treasury Department
Internal Revenue Service
Revised June 1933

Mailed
Aug. 20, 1933

To be stamped by Collector, showing
district and date received

1933 RETURN
of
CAPITAL STOCK TAX
For Year Ending June 30, 1933

DOMESTIC CORPORATIONS

(Sec. 215, National Industrial Recovery Act, 73d Congress, Public, No. 67)

This return must be filed with the Collector of Internal Revenue for your district on or before July 31, 1933, and the tax must be paid on or before that date.

TRIPLICATE

To Be Retained by Taxpayer

....

(Collection district)

Assessment List, Form 23A

....

(Month) (Year)

....

(Page) (Line)

Examined by:

....

1. Name—Western Shore Lumber Company,
2. Address—Room 2005, 111 Sutter Street, San Francisco, California
3. Name of parent company, if any — None. (District filed......)
4. Name of subsidiary, if any—None. No. shares held...... (District filed......)
5. Nature of business in detail—Lumber
6. Incorporated or organized in State of California, Month—November, Year—1905.

SEE INSTRUCTIONS ON REVERSE SIDE

7. Date of close of the last income-tax taxable year ending on or prior to the year ended

June 30, 1933*—December 31, 1932. *If no income-tax taxable year ending on or prior to year ended June 30, 1933, use date of organization.

8. Capital account as shown on balance sheet as of the date set forth in item 7 (no other date should be used):

	Number of shares	Par value per share	Total
(a) Common stock	10000	100.00	$1,000,000.00
(b) First preferred stock			None
(c) Second preferred stock			None
(d) Surplus (or deficit) Deficit			177,928.95
(e) Undivided profits			
(f) Total			822,071.05

Computation of Tax

9. Original declared value for entire capital stock as of the date shown in item 7	$1,250,000.00
10. Tax at rate of $1 for each full $1,000 in item 9 (omit cents)	1,250.00
11. Penalty of 25 percent for delinquency in filing return	
12. Interest	
13. Total tax, penalty and interest	

State of California,
County of San Francisco—ss.

We, Timothy Hopkins, President, and Myra Lane, Secretary of the corporation for which this return for capital stock tax imposed by section 215 of the National Industrial Recovery Act is made, being severally duly sworn, each for himself, deposes and says that the items entered in the fore-

going report, including any statements attached to or accompanying this return, are, to his best knowledge and belief and from such information as he has been able to obtain, true and correct.

TIMOTHY HOPKINS
President.
MYRA LANE
Secretary

Sworn to and subscribed before me this 17th day of August 1933.

[Seal] VIOLET NEUENBURG

Notary Public in and for the City and County of San Francisco
(Official capacity) [8]

EXHIBIT No. 2-A
(Copy)

Form 707
Treasury Department
Internal Revenue Service
Revised June 1934
Mailed Aug. 31, 1934
Check #950—$25.00
To be stamped by collector, showing district and date received
Duplicate

....
(Collection district)

Assessment List, Form 23A

....

(Month) (Year)

....

(Page) (Line)

Examined by:

....

1934 RETURN
OF
CAPITAL-STOCK TAX

For year ending June 30, 1934

DOMESTIC CORPORATIONS

(Sec. 701, Revenue Act of 1934, 73d Congress, Public, No. 216)

This return must be filed with the Collector of Internal Revenue for your district on or before July 31, 1934, and the tax must be paid on or before that date.

1. Name—Western Shore Lumber Company.
2. Address—Room 2005-111 Sutter Street, San Francisco California.

(The address must be that of the principal place of business. Give "Street and number", "City or town", and "State")

3. Name of parent company, if any None (District filed........)
4. Name of subsidiary, if any None No. shares held .... (District filed........)

(Or attach list and state number of shares held; also districts where filed)

5. Nature of business in detail Lumber
6. Incorporated or organized in State of California Month November Year 1905

Declaration of the Value of the Capital Stock

Important.—Before declaring a value for the capital stock, carefully read the instructions below, as a value once declared cannot later be amended.

If you file your income tax return on a calendar year basis, or would do so if subject to income tax, declare in the space below a value for the entire capital stock of your corporation as of December 31, 1933, which you are willing to have accepted in this and subsequent years, as a basis, subject to statutory adjustments, on which to pay capital-stock tax and excess-profits tax.

If you file your income-tax return on a fiscal year basis, or would do so if subject to income tax, declare the value as of the close of such fiscal year.

If your corporation was organized during the year July 1, 1933, to June 30, 1934, both dates inclusive, and if neither the first calendar year nor the first fiscal year for income-tax purposes has ended during the year July 1, 1933, to June 30, 1934, both dates inclusive, declare the value as of the date of organization.

If your corporation is without a capital stock represented by shares, declare a value for the net worth of the corporation.

(See Instruction No. 3 for additional information)

7. *Value of entire capital stock—$25,000

*A specific and unqualified value must be shown in this space. If the capital stock is of no value insert the word "None."

Exemptions. (See Instruction No. 4)

8. Is exemption from the tax claimed? Answer Yes or No (........).

9. If exemption is claimed, check the block which shows basis of claim and furnish the information required on page 2.

Section 101, Revenue Act of 1934.

Insurance company.

Not doing business.

Computation of Tax

	For use of Taxpayer	For use of Department
10. Amount shown in item 7	$25,000	$..........
11. Tax at rate of $1 for each full $1,000 in item 10 (omit cents)	25	....
12. Penalty of 25 percent for delinquency in filing return	....	....
13. Interest	....	....
14. Total tax, penalty, and interest	25	....

AFFIDAVIT

We, the undersigned, president (or vice president, or other principal officer) and treasurer assistant treasurer or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by

him and is, to the best of his knowledge and belief, a true and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1934 and the Regulations issued thereunder.

[Corporate Seal]

TIMOTHY HOPKINS
(President or other principal officer) (State title)

MYRA LANE
Secretary
(Treasurer, Assistant Treasurer, or chief accounting officer) (State title)

Sworn to and subscribed before me this August 31, 1934.

[Notarial Seal]

JENNIE DAGGETT
Notary Public
(Signature of officer administering oath)

(See Instruction No. 7) [9]

REVENUE ACT OF 1934

TITLE V—CAPITAL-STOCK AND EXCESS-PROFITS TAXES

Section 701. Capital-Stock Tax

(a) For each year ending June 30, beginning with the year ending June 30, 1934, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part

of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

(b) For each year ending June 30, beginning with the year ending June 30, 1934, there is hereby imposed upon every foreign corporation with respect to carrying on or doing business in the United States for any part of such year an excise tax equivalent of $1 for each $1,000 of the adjusted declared value of capital employed in the transaction of its business in the United States.

(c) The taxes imposed by this section shall not apply:

(1) to any corporation enumerated in section 101;

(2) to any insurance company subject to the tax imposed by section 201, 204, or 207;

(3) to any domestic corporation in respect of the year ending June 30, 1934, if it did not carry on or do business during a part of the period from the date of the enactment of this act to June 30, 1934, both dates inclusive; or

(4) to any foreign corporation in respect of the year ending June 30, 1934, if it did not carry on or do business in the United States during a part of the period from the date of the enactment of this act to June 30, 1934, both dates inclusive.

(d) Every corporation liable for tax under this section shall make a return under oath within one month after the close of the year with respect to which such tax is imposed to the collector for the

district in which is located its principal place of business, or, if it has no principal place of business in the United States, then to the collector at Baltimore, Md. Such return shall contain such information and be made in such manner as the Commissioner, with the approval of the Secretary, may by regulations prescribe. The tax shall, without assessment by the Commissioner or notice from the collector, be due and payable to the collector before the expiration of the period for filing the return. If the tax is not paid when due, there shall be added as part of the tax, interest at the rate of 1 per centum a month from the time when the tax became due, until paid. All provisions of law (including penalties) applicable in respect of the taxes imposed by section 600 of the Revenue Act of 1926 shall, insofar as not inconsistent with this section, be applicable in respect of the taxes imposed by this section. The Commissioner may extend the time for making the returns and paying the taxes imposed by this section, under such rules and regulations as he may prescribe, with the approval of the Secretary, but no such extension shall be for more than 60 days.

(e) Returns required to be filed for the purpose of the tax imposed by this section shall be open to inspection in the same manner, to the same extent, and subject to the same provisions of law, including penalties, as returns made under title II of the Revenue Act of 1926.

(f) For the first year ending June 30 in respect of which a tax is imposed by this section upon any

corporation, the adjusted declared value shall be the value, as declared by the corporation in its first return under this section (which declaration of value cannot be amended), as of the close of its last income-tax taxable year ending at or prior to the close of the year for which the tax is imposed by this section (or as of the date of organization in the case of a corporation having no income-tax taxable year ending at or prior to the close of the year for which the tax is imposed by this section). For any subsequent year ending June 30, the adjusted declared value in the case of a domestic corporation shall be the original declared value plus (1) the cash and fair market value of property paid in for stock or shares, (2) paid in surplus and contributions to capital, (3) its net income, (4) the excess of its income wholly exempt from the taxes imposed by title I over the amount disallowed as a deduction by section 24(a) (5) of such title, and (5) the amount of the dividend deduction allowable for income-tax purposes, and minus (A) the value of property distributed in liquidation to shareholders, (B) distribution of earnings or profits, and (C) the excess of the deductions allowable for income-tax purposes over its gross income; adjustment being made for each income-tax taxable year included in the period from the date as of which the original declared value was declared to the close of its last income-tax taxable year ending at or prior to the close of the year for which the tax is imposed by this section. The amount of such adjust-

ment for each such year shall be computed (on the basis of a separate return) according to the income-tax law applicable to such year. For any subsequent year ending June 30, the adjusted declared value in the case of a foreign corporation shall be the original declared value adjusted (for the same income-tax taxable years as in the case of a domestic corporation), in accordance with regulations prescribed by the Commissioner, with the approval of the Secretary, to reflect increases or decreases in the capital employed in the transaction of its business in the United States.

Section 702. Excess-Profits Tax

(a) There is hereby imposed upon the net income of every corporation, for each income-tax taxable year ending after the close of the first year in respect of which it is taxable under section 701, an excess-profits tax equivalent to 5 per centum of such portion of its net income for such income-tax taxable year as is in excess of 12½ per centum of the adjusted declared value of its capital stock (or in the case of a foreign corporation the adjusted declared value of capital employed in the transaction of its business in the United States) as of the close of the preceding income-tax taxable year (or as of the date of organization if it had no preceding income-tax taxable year) determined as provided in section 701. If the income-tax taxable year in respect of which the tax under this section is imposed is a period of less than 12 months, such adjusted declared value shall be reduced to an amount

which bears the same ratio thereto as the number of months in the period bears to 12 months. For the purposes of this section the net income shall be the same as the net income for income-tax purposes for the year in respect of which the tax under this section is imposed.

(b) All provisions of law (including penalties) applicable in respect of the taxes imposed by title I of this act, shall, insofar as not inconsistent with this section, be applicable in respect of the tax imposed by this section, except that the provisions of section 131 of that title shall not be applicable.

Section 703. Capital-Stock Tax and Excess-Profits Tax Imposed by National Industrial Recovery Act

Sections 217(d) and (e) of the National Industrial Recovery Act are amended to read as follows:

> "(d) The capital-stock tax imposed by section 215 shall not apply to any taxpayer in respect of any year except the year ending June 30, 1933.
>
> "(e) The excess-profits tax imposed by section 216 shall not apply to any taxpayer in respect of any taxable year ending after June 30, 1934."

EXHIBIT No. A-3

(Copy)

Form 707
Treasury Department
Internal Revenue Service
Revised 1937
Mailed Jul 31 1935
Signed by Timothy Hopkins—President
Myra Lane—Secretary
Acknowledged by Jennie Daggett, Notary
To be stamped by collector showing district and date received

Duplicate—Page 3

. . . .
(Collection district)
Assessment List, Form 23A

. . . .
(Month) (Year)

. . . .
(Page) (Line)
(For Washington Use Only)

1935 RETURN
OF
CAPITAL-STOCK TAX

For Year Ending June 30, 1935

DOMESTIC CORPORATIONS

(Sec. 105, Revenue Act of 1935, as amended by Sec. 401 of the Revenue Act of 1936)

This return must be filed, in triplicate, and received by the Collector of Internal Revenue for

your district on or before July 31, 1935. The tax must be paid on or before that date.

1. Name—Western Shore Lumber Company.
2. Address—Room 2005, 111 Sutter Street, San Francisco, California.
3. Name of parent company, if any...... (District filed........)
4. Name of subsidiary, if any ...... No. shares held ...... (District filed ......)

(If more than one, attach list and state number of shares held by parent; also districts where filed)

5. Nature of business in detail Lumber (Timber stumpage)
6. Incorporated or organized in State of California Month November Day .... Year 1905
7. Was a capital-stock tax return filed for the preceding taxable year ended June 30, 1934? Yes. If filed under a different name, state the name .... (District filed....)
8. Date of close of last income-tax taxable year ended on or prior to June 30, 1935, or, if newly organized corporation having no income-tax taxable year ended on or prior to June 30, 1935, date of organization December 31, 1934.

Corporations making an original declaration of value upon this return must enter the amount of such declared value in item 9. This block is not to be used by a corporation which established its origi-

nal declared value by the first return for the year ended June 30, 1934.

9. Original declared value of entire capital stock $..............

(The value declared must be definite and unqualified. A value must be declared in every case regardless of whether exemption from the tax is claimed. See instructions 1 and 3)

Corporations which have established their original declared value by the return for the year ended June 30, 1936, must adjust such declared value as provided for in Schedule I on page 2 of this return and then enter the amount of the adjusted declared value in item 10.

10. Adjusted declared value of entire capital stock as of Dec. 31, 1934 $24,536.44.

11. Exemptions.—The Act provides for an exemption from the tax only on the grounds indicated below. Corporations claiming exemption must (1) report a value for the capital stock under item 9 or 10, (2) check the appropriate block below, showing the basis of the claim, and (3) submit with the return a full statement of the evidence specified under the block checked.

Corporation exempt from income tax under section 101, Revenue Act of 1936. (1) State under which subsection of section 101...... (2) Furnish information required by instruction 14.

Insurance company subject to tax under section 201, 204, or 207, Revenue Act of 1936.

State which section......

Corporation not doing business. (1) Furnish information required by instruction 16. (2) Report value of capital stock in item 9 or 10 above.

Computation of Tax

		For use of Taxpayer	For use of Department
12.	Amount reported in item 9 or 10......	$24,536.44	$..........
13.	Tax at rate of $1 for each full $1,000 in item 12 (omit cents)..........	24	....
14.	Penalty of .... per cent for delinquency in filing return..........	....	....
15.	Interest at 6% per annum beginning August 1, 1937..........	....	....
16.	Total tax, penalty, and interest..........	....	....

We, the undersigned (Name of president, vice president, or other principal officer), (Title) and (Name of treasurer, assistant treasurer, or chief accounting officer), (Title), of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including any accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1935, as amended, and the Regulations issued thereunder.

[Corporate Seal]

....

(Name)

. . . .
(Title)

. . . .
(Name)

. . . .
(Title)

[Notarial Seal]

. . . .
(Name)

. . . .
(Official capacity of officer administering oath) [101]

The schedules on this page must be filled in by every corporation making adjustments to an original declared value for the capital stock established by the return for the year ended June 30, 1934. See instructions 5 to 9, inclusive.

Schedule I. Adjustment of Original Declared Value of Entire Capital Stock for All Transactions During the Income-Tax Taxable Year Ended December 31, 1934.

Original declared value as established by the first return for the taxable year ended June 30, 1934.....$25,000.00

Additions:

(1) (a) Total cash paid in for stock or shares (see instruction 7, item 1) $............

(b) Fair market value of all property received for stock or shares (see instruction 7, item 1)............ ....

(2) Paid-in surplus and contributions to to capital (see instruction 7, item 2) ....

(3) Net income (see instruction 7, item 3) Loss .... 463.56†

(4) Excess of income wholly exempt from tax over amount disallowed as deduc-

tions by section 24(a)(5) of the Revenue Act of 1934 or 1936 (see instruction 7, item 4) ....

(5) Dividend deduction allowable for income-tax purposes (see instruction 7, item 5) ....

Total additions ....

Total before deductions $25,000.00

Deductions:

(A) (1) Total cash distributed in liquidation to shareholders (see instruction 7, item A) None

(2) Fair market value of all property distributed in liquidation to shareholders (see instruction 7, item A) None

(B) Distributions of earnings or profits (see instruction 7, item B) None

(C) Excess of deductions allowable over gross income and claimed on income-tax return (see instruction 7, item C) ....

Total deductions 463.56

Adjusted declared value (enter in item 10, page 1) $24,536.44

†Indicates red figures.

Schedule II. Analysis of Changes in Capital Stock and Surplus

Capital Stock and Surplus at beginning of year

1.	Capital stock: Preferred	$ ....
	Common	1,000,000.
2.	Capital or paid-in surplus	....
3.	Surplus reserves—Capital surplus	449,140.95
4.	Surplus and undivided profits	....

Additions—Capital transactions

5. Total cash and fair market value of property paid in for stock or shares (total of items 1(a) and 1(b), Schedule I)*	
6. Paid-in surplus and contributions to capital (item 2, Schedule I)*	
7. Other additions (to be detailed)	

Additions—Revenue transactions

8. Net income (item 3, Schedule I)	
9. Income wholly exempt from income tax. (This total less the amount entered as item 17 of this schedule should correspond with item 4, Schedule I) (See instruction 7, item 4)	
10. The amount of the dividend deduction allowable for income-tax purposes (item 5, Schedule I) (see instruction 7, item 5)	
11. Other additions (to be detailed)	
Total	$1,449,140.95

Deductions—Capital transactions

12. Liquidating distributions (total of items A(1) and A(2), Schedule I)*	$
13. Other distributions (item B, Schedule I)*	
14. Enter class and amount of distributions in corporation's own stock: ... $	x x x x
15. Other deductions (to be detailed)	

Deductions—Revenue transactions

16. Excess of deductions allowable over gross income and claimed on income-tax return (item C, Schedule I)	463.56
17. Deductions disallowed by sec. 24(a)(5), 1934 or 1936 Act. (See item 9 of this schedule)	
18. Other deductions (to be detailed)	

Capital Stock and Surplus at end of year

19. Capital stock: Preferred	
Common	1,000,000.00

20.	Capital or paid-in surplus	....
21.	Surplus reserves—Capital surplus	448,677.39
22.	Surplus and undivided profits	....
	Total	$1,449,140.95

*Enter values shown by the books if different from values entered in Schedule I and explain difference.

EXHIBIT No. A-4

(Copy)

Form 707

Treasury Department

Internal Revenue Service

Revised 1936

To be stamped by collector, showing district and date received

Duplicate—Page 3

. . . .

(Collection district)

Assessment List, Form 23A

. . . .

(Month) (Year)

. . . .

(Page) (Line)

(For Washington Use Only)

1936 RETURN

OF

CAPITAL-STOCK TAX

For Year Ending June 30, 1936

DOMESTIC CORPORATIONS

(Sec. 105, Revenue Act of 1935, 74th Cong., Public, No. 407)

This return must be filed, in triplicate, with the Collector of Internal Revenue for your district on or before July 31, 1936, and the tax must be paid on or before that date.

1. Name—Western Shore Lumber Company.
2. Address—4 Montgomery Street, San Francisco, California.
3. Name of parent company, if any...... (District filed......)
4. Name of subsidiary, if any...... No. shares held........ (District filed........)

(If more than one, attach list and state number of shares held by parent; also districts where filed)

5. Nature of business in detail Lumber (Timber stumpage)
6. Incorporated or organized in State of California Month November Day .... Year 1905
7. Was a capital-stock tax return filed for the preceding taxable year ended June 30, 1935? If filed under a different name, state the name............ (District filed First Calif)
8. Declared value of entire capital stock...... $1,000,000.00.

(The value declared must be definite and unqualified. A value must be declared in every case regardless of whether exemption from the tax is claimed. See instructions 1 and 2.)

9. Exemptions.—The Act provides for an exemption from the tax only on the grounds indicated below. Corporations claiming exemption must (1) declare a value for the capital stock under item 8, (2) check the appropriate block under item 9 showing the basis of the claim, and (3) submit with the return a full statement of the evidence specified under the block checked.

Corporation exempt from income tax under section 101, Revenue Act of 1934. (1) State under which subsection of section 101...... (2) Furnish information required by instruction 4.

Insurance company subject to tax under section 201, 204, or 207, Revenue Act of 1934. State which section........

Corporation not doing business. (1) Furnish information required by instruction 6. (2) Declare value of capital stock in item 8 above.

Computation of Tax

	For Use of Taxpayer	For Use of Department
10. Declared value (must be identical figure entered in item 8)	$1,000,000.00	$
11. Tax at rate of $1.40 for each full $1,000 in item 8	1,000.00	
12. Penalty for delinquency in filing returns (see inst. 7)	—	
13. Interest at 6 percent per annum beginning August 1, 1936	8.33	
14. Total tax, penalty, and interest $	1,008.33	

15. State amounts of outstanding capital stock and surplus as of date of the close of income-tax taxable year used in declaring value for capital stock. (If nonstock organization, so indicate and attach statement of net worth.)

	Number of Shares	Par (Stated) Value per Share	Totals
Capital stock: Preferred			
Common	10,000	100.00	1,000,000.00
Capital or paid-in surplus	x x	x x	—
Surplus reserves	x x	x x	—
Surplus and undivided profits	x x	x x	450,192.12

We, the undersigned Percy A. Wood, President and Myra Lane, Secretary, of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including any accompanying statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return, made in good faith, for the taxable year stated,

pursuant to the Revenue Act of 1935 and the Regulations issued thereunder.

[Corporate Seal]

PERCY A. WOOD,
President

....
Secretary

Sworn to and subscribed before me this .... day of September, 1936.

[Notarial Seal]

....
(Name)

....
(Official capacity of officer administering oath) [11]

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
San Francisco, Calif.

Jul 39, 1936

[Seal]

Office of the Collector First District of California
In replying refer to
Western Shore Lumber Co.,
4 Montgomery St.,
San Francisco Calif.

Receipt is acknowledged of your application dated 29 July 1936 requesting for the reasons therein given an extension of time within which to file your capital stock tax return for the year ending June 30,

1936. In no case can an extension be granted beyond September 29, 1936.

You are hereby granted an extension of time to Sep 29 1936 within which to file your return and make payment of the tax shown thereon to be due.

In all cases where an extension of time is granted interest is collectible at the rate of one-half of one per cent a month from the due date, July 31, 1936, up to and including the date of payment.

This letter, or a copy thereof, must be attached to the return when filed as authority for the extension of time herein granted.

Respectfully,

GUY T. HELVERING,

Commissioner.

By JOHN V. LEWIS

Collector

TJC/om GMA [12]

EXHIBIT B-1

To Be Filed in Duplicate

Form 843

Treasury Department

Internal Revenue Service

Revised June 1930

CLAIM

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

Exhibit B-1 (Continued)

☐ Refund of Tax Illegally Collected.

☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

☐ Abatement of Tax Assessed (not applicable to estate or income taxes).

Collector's Stamp (Date received)

State of California
City and County of San Francisco—ss.

Type or Print

Name of taxpayer or purchaser of stamps—Western Shore Lumber Company.

Business address—403 Merchants Exchange Building, San Francisco, California.

Residence—

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed—First District, California.

2. Period (if for income tax, make separate form for each taxable year)—Year ending June 30, 1933.

3. Character of assessment or tax—Capital stock tax.

4. Amount of assessment, $1,250; dates of payment—August 29, 1933.

5. Date stamps were purchased from the Government—

6. Amount to be refunded—$1250 with interest thereon at the rate of 6%.

Exhibit B-1 (Continued)

7. Amount to be abated (not applicable to income or estate taxes)—

8. The time within which this claim may be legally filed does not expire prior to August 29, 1937 (See Revised Stats. Sec. 3228, as amended.)

The deponent verily believes that this claim should be allowed for the following reasons:

(For statement of grounds for refund, see pages attached hereto and hereby made a part hereof.)
(Attach letter-size sheets if space is not sufficient)

WESTERN SHORE LUMBER COMPANY

(Signed) By FRANK C. NELSON
Secretary

Sworn to and subscribed before me this 27th day of August 1937.

[Seal] FRANK L. OWEN

Notary Public in & for the city & county of San Francisco, State of California. [13]

(See instructions on reverse side)

CERTIFICATE

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax: Character of assessment and period covered, List, Year, Month Account No. or Page Line Amount assessed $______. Total, $______.

Paid, Abated, or Credited Dated, Amount, Total, $______.

Claim No.______.

I certify that the records of this office show the

Exhibit B-1 (Continued)

following facts as to the purchase of stamps: To Whom Sold or Issued, Kind, Number, Denomination, Date of sale or issue, Amount $------.

If special tax stamp, state: Serial number, Period commencing.

Collector of Internal Revenue.

................................(District)

Claim examined by------.

Claim approved by------ Chief of Division.

Amount claimed-- $------.

Amount allowed-- $------.

Amount rejected--$------.

COMMITTEE ON CLAIMS

INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

Exhibit B-1 (Continued)

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

FACTS

The Western Shore Lumber Company, a corporation organized and existing under and by virtue of the laws of the State of California, hereinafter called the taxpayer, has paid to the Collector of Internal Revenue at San Francisco, California, certain amounts constituting capital stock tax assessed against the taxpayer, in the amounts and for the years herein indicated, to wit:

Exhibit B-1 (Continued)

Date of Assessment	Date of Payment	Amount
June 30, 1933	August 29, 1933	$1,250.00
June 30, 1934	August 31, 1934	25.00
June 30, 1935	July 31, 1935	24.00
June 30, 1936	September 18, 1936	1,000.00

The payment of these taxes by the taxpayer constituted capital stock tax assessed for the years 1933, 1934, 1935 and 1936, paid as set forth above.

All of said taxes were paid through inadvertence and without the knowledge of the taxpayer's rights in the premises and should be refunded for the reason that the taxpayer was not at any time during the period from July 1, 1932 to June 30, 1936 and is not now carrying on or doing business. The sole function of this corporation [14] then was and continues to be the holding of its assets until such time as the same can be satisfactorily liquidated and distributing the proceeds currently received on account of such assets. Under the Regulations of the Bureau of Internal Revenue, as then and now in effect, a corporation whose sole activities are limited to the distribution of the avails of property and the doing only of such acts as may be necessary for the maintenance of its corporate status in a case in which the corporation has reduced its activities to the mere owning and holding of specific property is not subject to the capital stock tax.

The taxpayer has neither done nor attempted to do any business whatsoever since early in 1922, at which time a mill erected in 1917 was shut down and has not since been operated. In this connection it is to be noted that the taxpayer has filed refund claims

Exhibit B-1 (Continued)

for capital stock taxes paid for the years from 1923 to 1928, which refund claims were allowed by the Bureau of Internal Revenue and paid to the taxpayer.

The taxpayer has itself engaged in no timber operations since 1917, with the exception of a small stumpage which was cut in 1920. The only receipts of the taxpayer for the period from July 1, 1932 to June 30, 1936, were interest on bank accounts and receipts on account of [15] a stumpage contract under which the taxpayer liquidated certain of its timber holdings and receipts in the total amount of $208.08 on account of the sale of equipment and junk. A copy of this stumpage contract is attached hereto as are detailed statements of the cash receipts and disbursements of the taxpayer for each of the taxable years in question. There is also attached hereto a copy of the minutes of all meetings of the Board of Directors during the period from July 1, 1932 to June 30, 1936.

The taxpayer now has and during this period had no employees other than a secretary and it has performed no corporate acts other than the payment of taxes and the management of affairs purely internal in character necessary to the preservation of its charter. A copy of the taxpayer's article of incorporation has heretofore been supplied to the Commissioner of Internal Revenue in connection with the above mentioned claims of the taxpayer for refund of previous capital stock taxes. We refer you to your file Nos. Misc. TJO'N; 114 and MT-M-JH Claim No. 3-R2646.

Exhibit B-1 (Continued)

The taxpayer has neither acquired nor sold any property during the period herein mentioned and has paid no dividends to any stockholders.

No corporate functions set forth in its articles of incorporation as to business purposes have been performed. [16] It is not necessary under the law of California to amend the articles of incorporation when a corporation ceases to carry on operations.

The taxpayer merely owns and holds approximately 13,000 acres of timber land in San Mateo County, California, and approximately 550 acres in Santa Cruz County, California.

The taxpayer has not during the period here mentioned and does not now own any stock of other corporations nor is it nor has it been affiliated with any other corporation.

It is therefore submitted that the taxpayer has not carried on or done business during any of the taxable years herein mentioned and that accordingly the taxpayer is not and was not subject to capital stock tax for the years ending June 30, 1933, June 30, 1934, June 30, 1935 and June 30, 1936.

The taxpayer comes squarely within the holding of the United States District Court in

Clallam Lumber Co. v. United States, 34 Fed. (2d) 947 (1929).

In that case a corporation whose sole function was the holding of timber lands for sale as soon as a fair price could be obtained was held to be not subject to the capital stock tax imposed by the Revenue Act of 1924, although the taxpayer had entered into a logging contract [17] requiring the vendee to cut

Exhibit B-1 (Continued)

and remove merchantable timber and had entered into an agreement for the construction and operation of a private logging railroad for the purpose of making its timber salable. The activities of the taxpayer in that case were considerably more extensive than the activities of the taxpayer in the present case and the logging contract was substantially similar to the stumpage contract of the petitioning taxpayer with the Santa Cruz Lumber Co.

The taxpayer's exemption is also supported by the holding of the Circuit Court of Appeals for the Fifth Circuit in

> Lane Lumber Company v. Hynson, 4 Fed. (2d) 666 (1925),

where the charter of the company, as in the present situation, allowed broad powers to hold, lease and sell real and personal property and to buy, sell, hold and lease real estate, timber, logs, stumpage and building materials. During the tax period in question, however, the company had ceased to do any lumbering or lumber business. It did, however, appoint agents to attempt to sell its lands, pay taxes and continue to hold title to its lands. The court held it was not subject to the capital stock tax imposed under the Revenue Act of 1919.

See also the case of

> United States v. Hotchkiss Redwood Co., 25 Fed. (2d) 958, [18]

and

> Cannon v. Elk Creek Lumber Company and Cannon v. Siuslaw Lumber Company, 8 Fed. (2d) 996,

Exhibit B-1 (Continued)

in which the court held that corporations which merely own and hold tracts of timber land engaged only in activities incident to the ownership of such property are not carrying on or doing business within the meaning of the provisions imposing the capital stock tax.

Therefore, on the basis of the facts hereinabove set forth and in the light of the above authorities, the taxpayer respectfully submits that it is entitled to refund in the amounts of $1250, $25.00, $24.00 and $1000 for capital stock taxes for the taxable years ending June 30, 1933, June 30, 1934, June 30, 1935 and June 30, 1936. [19]

WESTERN SHORE LUMBER COMPANY

CASH RECEIPTS AND DISBURSEMENTS

July 1, 1932 to June 30, 1933

Receipts

Receipts under Stumpage Contract with Santa Cruz Lumber Co.			$21,206.70
Interest on Bank Accounts			451.44
Savings Account		257.28	
Commercial Account		194.16	
Total Receipts			21,658.14

Disbursements

Taxes			6,024.75
Timber Lands		5,998.47	
San Mateo County	5,634.20		
Santa Clara County	364.27		
State Franchise Tax		25.00	
Federal Check		1.28	

Exhibit B-1 (Continued)

Disbursements—(Continued)

Interest on Loans		4,011.05
Trail Maintenance		1,650.00
Secretarial Expense		550.00
General Expenses		364.60
Office Rent	275.00	
Accounting Services	60.00	
Repairs	18.20	
Rent—Safe Deposit Box	8.80	
Miscellaneous	2.60	
		12,600.40
Excess Receipts Over Disbursements		9,057.74
Balance Cash July 1, 1932		26,617.00
The Bank of California, N. A.— Savings Account	7,853.12	
The Bank of California, N. A.— Commercial Account	18,763.88	
Balance Cash June 30, 1933		35,674.74
Wells Fargo Bank & Union Trust Co.— Savings Account	33,592.86	
Wells Fargo Bank & Union Trust Co.— Commercial Account	2,081.88	

[20]

No Minutes of Meetings of Board of Directors

for Year

July 1, 1932 to June 30, 1933 [21]

Exhibit B-1 (Continued)

WESTERN SHORE LUMBER COMPANY
San Francisco, California

BALANCE SHEETS

Assets

	Jan. 1-32	Dec. 31-32
Cash	$ 30,912.46	36,458.26
Timber	1,503,853.36	1,491,412.71
Real Estate	66,195.55	66,195.55
Buildings	1,250.98	1,250.98
Total	1,602,212.35	1,595,317.50

Liabilities

Deposit on Stumpage	40,000.00	40,000.00
Stockholders' Loans	66,850.75	66,850.75
Common Capital Stock	1,000,000.00	1,000,000.00
Surplus & Appreciation Reserves	495,361.60	488,466.75
Total	1,602,212.35	1,595,317.50

[22]

This Agreement, made and entered into this 23d day of April, 1929, by and between Western Shore Lumber Company, a corporation, organized and existing under and by virtue of the laws of the State of California, first party, and Santa Cruz Lumber Company, a corporation, organized and existing under and by virtue of the laws of the State of California, second party,

Witnesseth:

That, Whereas, first party is the owner of the following described timber lands, to-wit:

All those certain lots, pieces or parcels of land situate, lying and being in the County of San Mateo, State of California, and more

Exhibit B-1 (Continued)

particularly described as follows, to-wit:

The East one-half (E½) and the East one-half (E½) of the West one-half (W½) of Section 22, Township 8 South, Range 3 West M.D.B. & M.

and

Whereas, second party desires to acquire the right to cut, fell and remove the redwood and pine timber and the tanbark on said timber lands as hereinbefore provided;

Now, Therefore, in consideration of the premises and of the sum of ten thousand (10,000) dollars in cash to first party in hand paid by second party concurrently with the execution of these presents, the parties hereto hereby mutually agree as follows:

(1) Second party shall have the right to cut, fell, and remove from the timber lands hereinabove particularly described, all the redwood and pine timber and tanbark [23] which it may desire to take growing, standing or being on said lands for the price and prices hereinafter provided; and for the purpose of cutting, felling and removing said timber and tanbark as hereinabove provided, second party shall have possession of said lands for the term hereinafter provided and shall have the right during such term to cut out and construct roads over and cross the same, and to have free ingress and egress for employees, teams, and vehicles into, upon and from the said timber lands.

(2) The price or prices payable by second party to the first party for the right to cut, fell and

Exhibit B-1 (Continued)

remove said timber and tanbark shall be the following:

(a) The said sum of ten thousand (10,000) dollars paid concurrently with the execution of these presents as hereinbefore recited, which amount shall be considered as having become due to first party regardless of the amount of timber and tanbark cut, felled or removed by the second party.

(b) An amount based upon the timber and tanbark cut, felled and/or removed by second party at the rate of four (4.00) dollars per thousand feet, board measure, in the case of redwood and pine timber, and at the rate of five (5.00) dollars per cord in the case of tanbark, provided, that there shall be credited against amounts due on account of said timber and tanbark the full amount of ten thousand (10,000) dollars above mentioned, and no payments shall be made by the second party to the first party under this subdivision (b) until the amounts determined at the rates in this subdivision provided shall aggregate more than ten thousand (10,000) dollars; all ex- [24] cess amounts shall be payable to the first party monthly on the first day of each and every month.

(3) The determination of the number of thousand feet, board measure, of redwood and pine timber cut, felled and removed by the second party shall be made by a tally at the tail end of the mill of second party. If first party shall so elect, said tally shall be made by a tallyman mutually agreed upon by the parties, or appointed by the first party,

Exhibit B-1 (Continued)

and the expense of the employment of such tallyman for the purpose of the tally shall be divided equally between the parties. The determination of the amount of tanbark cut by second party shall be made prior to its removal from said timber lands of first party, and if first party shall so elect, shall be made by a person agreed upon between the parties or appointed by first party, and the expense of the employment of such person for such purpose shall be borne equally by the parties.

(4) First party shall have the right at any time through its officers, agents or representatives to inspect the operations of the second party on the said timber lands and the method of tallying hereinabove provided for. First party shall also have the right at any time through its officers, agents or representatives to examine the books of account of second party and all other records of second party covering the operations of said second party on the said timber lands of first party.

(5) The second party shall from and after the date of this agreement proceed continuously with the cutting, felling and removing of said timber and tanbark from the lands herein described, and shall complete the same within [25] a period of two years from the date hereof. Upon the expiration of the said two years from the date hereof, all further rights of said second party in and to said timber and tanbark on the lands of the first party, and all rights of the second party in and to said lands and to ingress and egress therefrom shall cease and de-

Exhibit B-1 (Continued)

termine, and the first party shall have the exclusive right and possession of same and of any timber or tanbark remaining thereon.

(6) The legal title to all timber and tanbark upon the lands of the first party, covered by this agreement, shall remain in first party until the same be cut, felled and removed by second party and after such cutting, felling and removal, the legal title to and the right of possession of the same and of any lumber manufactured therefrom shall be and remain in the first party as security for any portion of the purchase price hereinabove provided which may then remain due and unpaid until the same shall have been fully paid; and second party agrees at all times to keep on hand a sufficient quantity of said timber, tanbark and lumber separately piled to secure the balance owing, if any, to first party; and in case of default by second party in making any of the payments hereunder and in performing any of the conditions hereof, first party shall, in addition to other rights in such case provided, have the right to take immediate possession of said timber, tanbark and lumber, and to sell and dispose of same at public or private sale, without notice to the second party, for the purpose of satisfying the balance due under this contract and all costs and expenses in taking, keeping and [26] disposing of said property.

(7) Second party agrees to so conduct its operations upon said lands above described as not to damage unnecessarily any young growth or trees left

Exhibit B-1 (Continued)

standing by second party, and not to damage in any way any buildings or improvements on said lands.

(8) All slash and cuttings resulting from operations of second party on the lands herein described may be sold by first party for fuel, or other purposes, if first party so elects, but if first party does not so elect, second party agrees to either remove the same or to destroy the same by burning during the rainy season when no danger of forest fire will result.

(9) Second party agrees to indemnify and to save and hold first party harmless of and from any and all liens and claims whatsoever arising from its operations on said lands of first party. Second party further agrees that first party shall not be liable or responsible for any accidents, loss, injury, or damage happening, accruing, or in connection with, or anywise arising out of the work herein referred to, or any of the operations of second party hereunder to persons and/or property (whether employed upon or utilized in said work, or otherwise, and including the death of any persons) and second party agrees to fully indemnify and save and hold first party harmless of, from and aganist the same and any and all liability, expenses (including attorneys' fees) payments, claims and/or liens whatsoever therefor.

(10) During the term of this agreement second party agrees to do all in its power to prevent and suppress fires [27] on the lands heerinabove described and in the vicinity and to acquire its em-

Exhibit B-1 (Continued)

ployees to do likewise. In the event that any fire shall start on the lands above described, or in its vicinity, second party agrees to place all its employees in that logging area to work in fighting such fire and to keep them constantly and continuously at work fighting such fire until it shall be extinguished.

(11) No assignment of this agreement shall be made by second party either voluntarily or by operation of law, proceedings in bankruptcy, or otherwise, without the written consent of the first party and any such attempted assignment without such written consent shall be null and void.

(12) In the event that second party shall make default in the payment of any amount due under this contract, as hereinabove provided, or in the performance or observance of the terms, conditions and agreement herein contained on its part to be performed or observed, first party may at its option treat this agreement as terminated without notice of said option given to second party, and thereupon this agreement shall become null and void, and the rights of second party shall come to an end, and second party shall have no further right, title and interest, claim or demand whatsoever, under or by virtue of this agreement in or to the timber lands hereinabove described, or the timber or tanbark thereon, or in or to said sum of ten thousand (10,000) dollars paid concurrently herewith, or in or to any further payments theretofore made by second party to first party, but said sum

Exhibit B-1 (Continued)

or sums shall [28] be retained by and shall belong to first party as liquidated and agreed damages and not as a penalty. Nothing herein contained shall be construed as depriving first party of any right to further damages or to any other right or remedy to which it may be entitled at law or in equity on the happening of such default.

(13) Time is of the essence of this agreement.

(14) Subject to the provisions of paragraph (11) above, this agreement shall bind and inure to the benefit of the successors and assigns of the respective parties hereto.

In Witness Whereof the parties have caused their respective corporate names to be hereunto subscribed and their respective seals to be hereunto affixed by their respective officers thereunto duly authorized, all in duplicate, the day and year first above written.

[Corporate Seal]

WESTERN SHORE LUMBER COMPANY,

By TIMOTHY HOPKINS,

Pres.

By WALTER L. DEAN,

Secretary.

[Corporate Seal]

SANTA CRUZ LUMBER COMPANY,

By GEORGE M. LEY,

Treas.

By JAS. M. MADDOCK,

Secty. [29]

EXHIBIT B-2

(To Be Filed in Duplicate)

Form 843
Treasury Department
Internal Revenue Service
Revised June 1930

CLAIM

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

☐ Refund of Tax Illegally Collected.

☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

☐ Abatement of Tax Assessed (not applicable to estate or income taxes).

Collector's Stamp (Date received)

State of California,
City and County of San Francisco—ss.

Type or Print.

Name of taxpayer or purchaser of stamps, Western Shore Lumber Company.

Business address, 403 Merchants Exchange Building, San Francisco, Calif.

Residence

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

Exhibit B-2 (Continued)

1. District in which return (if any) was filed, First District, California.

2. Period (if for income tax, make separate form for each taxable year) Year ending June 30, 1934.

3. Character of assessment or tax, Capital stock tax.

4. Amount of assessment, $25.00; dates of payment, August 31, 1934.

5. Date stamps were purchased from the Government

6. Amount to be refunded, $25 with interest thereon at the rate of 6%.

7. Amount to be abated (not applicable to income or estate taxes)

8. The time within which this claim may be legally filed does not expire prior to August 31, 1938. (See Revised Stats. Sec. 3228, as amended.)

The deponent verily believes that this claim should be allowed for the following reasons:

(For statement of grounds for refund, see pages attached hereto and hereby made a part hereof.)

(Attach letter-size sheets if space is not sufficient)

WESTERN SHORE LUMBER COMPANY,

[Signed] By FRANK C. NELSON, Secretary.

Exhibit B-2 (Continued)

Sworn to and subscribed before me this 27th day of August, 1937.

[Notarial Seal]

FRANK L. OWEN,

Notary Public in and for the City and County of San Francisco, State of California.

(See Instructions on Reverse Side)

[30]

CERTIFICATE

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax: Character of assessment and period covered, List, Year, Month, Account No. or Page, Line, Amount assessed, $............ Total, $............

Paid, Abated, or Credited, Date, Amount, $............ Total, $............

Claim No. ....

I certify that the records of this office show the following facts as to the purchase of stamps: To Whom Sold or Issued, Kind, Number, Denomination, Date of sale or issue, Amount, $............

If special tax stamp, state: Serial number, Period commencing.

...., ...

Collector of Internal Revenue. (District)

Exhibit B-2 (Continued)

Claim examined by—..

Claim approved by—..

Chief of Division.

COMMITTEE ON CLAIMS

....

....

....

Amount claimed.... $....................

Amount allowed.... $....................

Amount rejected.... $....................

INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to

Exhibit B-2 (Continued)

show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

> [On the original there is here inserted a copy of Statement of Facts. Copy of this Statement of Facts appears in the Claim for Refund for the year 1933.] [31]

WESTERN SHORE LUMBER COMPANY

CASH RECEIPTS AND DISBURSEMENTS

July 1, 1933 to June 30, 1934

Receipts

Receipts under Stumpage Contract with Santa Cruz Lumber Co.	$32,372.78
Interest—Special Savings Account with Wells Fargo Bank & Union Trust Company	841.56
Total Receipts	33,214.34

Exhibit B-2 (Continued)

Disbursements

Payment on Principal of Outstanding Loans			13,821.89
Interest on Loans			5,613.73
Taxes			5,610.86
Timber Lands		4,334.58	
San Mateo County	4,042.17		
Santa Cruz County	292.41		
Federal Capital Stock		1,250.00	
State Franchise		25.00	
Federal Check		1.28	
Trail Maintenance			1,800.00
Secretarial Expense			275.00
General Expenses			364.94
Office Rent		275.00	
Tax Preparation		25.00	
Miscellaneous		7.94	
Insurance		57.00	
Total Disbursements			27,486.42
Excess Receipts Over Disbursements			5,727.92
Balance Cash July 1, 1933			35,674.74
Wells Fargo Bank & Union Trust Co.—Savings Account		33,592.86	
Wells Fargo Bank & Union Trust Co.—Commercial Account		2,081.88	
Balance Cash June 30, 1934			41,402.66
Wells Fargo Bank & Union Trust Co.—Savings Account		34,434.42	
Wells Fargo Bank & Union Trust Co.—Commercial Account		6,968.24	

Exhibit B-2 (Continued)

WESTERN SHORE LUMBER COMPANY

Copies of Minutes of Meetings of Board of Directors, July 1, 1933 to June 30, 1934

Minutes of Special Meeting of Board of Directors of

WESTERN SHORE LUMBER COMPANY

Pursuant to call and notice by the President, as provided in the by-laws, a special meeting of the Board of Directors of Western Shore Lumber Company, a California corporation, was held at the office of the corporation at Room 905, Kohl Building, San Francisco, California, on Wednesday, the 5th day of July, 1933, at the hour of 11:00 o'clock A. M. of said day. The following Directors were present, constituting a quorum:

Timothy Hopkins
Andrew Thorne
Percy A. Wood.

President Hopkins presided and on motion duly made, seconded and adopted, Mr. Wood was appointed Secretary of the meeting, and thereafter acted as Secretary.

The President's call and notice of the meeting was presented and, on motion duly made and seconded, was made a part of the records of the meeting. Said call and notice is as follows:

Exhibit B-2 (Continued)

Call and Notice of Special Meeting of Board of Directors of Western Shore Lumber Company.

The undersigned, President of Western Shore Lumber Company, hereby calls a special meeting of the Board of Directors of said corporation to be held at its office, Room 905 Kohl Building, San Francisco, California, on Wednesday, the 5th day of July, 1933, at 11:00 o'clock A. M., for the purpose of considering and acting upon any and all business which may come before the said meeting.

Because the office of Secretary of the corporation is vacant, the undersigned also hereby gives notice that said special meeting of the Board of Directors has been called to be held and will be held at the said time and place for the purpose above mentioned.

[Signed] TIMOTHY HOPKINS,
President of Western Shore Lumber Company.

Dated at San Francisco, California, June 30, 1933. [33]

The President stated that because the office of Secretary had been vacant he had himself given notice of the meeting in accordance with the by-laws by depositing, with postage thereon prepaid, in the United States mail at San Francisco, California, a counterpart of the said call and notice of the meeting addressed to each Director at his place of business or residence at least thirty-six hours before the time fixed for the holding of the meeting, namely on the 30th day of June, 1933.

Exhibit B-2 (Continued)

The President reported to the Board the death of Mr. Walter L. Dean, who for many years had been Director, Secretary and Treasurer of the corporation. On motion duly made, seconded and carried, it was resolved that the President, on behalf of the corporation, express to Mrs. Walter L. Dean the sympathy of the Board and its appreciation of the long and faithful service of Mr. Dean as Officer and Director.

The President thereupon called for nominations for the office of Secretary left vacant by the death of Mr. Dean. Miss Myra Lane was thereupon nominated as Secretary and there being no further nominations, on motion duly made and seconded, the nominations were declared closed. An election by ballot was thereupon held in which Miss Lane received the vote of all Directors present. The President thereupon declared that Miss Myra Lane was elected Secretary of the corporation. She was not present at the meeting and accordingly Mr. Wood continued to act as Secretary of the meeting.

On motion duly made and seconded, the following resolution was adopted by the vote of all Directors present:

> Resolved, that the Secretary of this corporation shall receive and be paid a salary of $25.00 per month and that the officers of this corporation authorized to sign checks be and they are hereby authorized and empowered to pay said salary to the Secretary monthly hereafter until further order of the Board of Directors.

Exhibit B-2 (Continued)

It was decided not to fill at this time the vacancy in the Board of Directors or in the office of Treasurer created by Mr. Dean's death and no action was taken to this end.

The President then stated that he considered it advisable to provide for banking arrangements for the corporation at Wells Fargo Bank and Union Trust Co. Thereupon, on motion duly made and seconded, the following resolutions were adopted by the vote of all Directors present:

> Resolved, that Wells Fargo Bank & Union Trust Co. be and it is hereby selected as a depositary for the funds of this corporation and that said funds shall be withdrawn from said depositary on the check of this corporation signed by either Timothy Hopkins, the President of this corporation, alone, or A. Crawford Greene, the Vice President of this corporation, alone, or Percy A. Wood, Director of this corporation, and Myra Lane, Secretary of this corporation, together; and
>
> Further Resolved, that any one of said four officers above named individually be and he is hereby authorized for and on behalf of and in the name of this corporation [34] to endorse and to deliver to said depositary for any purpose and to any amount commercial paper of any kind, negotiable or non-negotiable, executed by others and owned or held by or payable to this corporation; and

Exhibit B-2 (Continued)

Further Resolved, that the authority hereby conferred shall continue in force until notice of its revocation in writing shall have been given to the said depositary.

On motion duly made and seconded, the following resolution was adopted by the vote of all Directors present:

Resolved, that this corporation do rent a safe in the safe deposit vault of Wells Fargo Bank & Union Trust Co., San Francisco, California, and that either Timothy Hopkins, the President of this corporation, alone, or A. Crawford Greene, the Vice President of this corporation, alone, or Percy A. Wood, Director of this corporation, and Myra Lane, Secretary of this corporation, together, be and is or are hereby authorized to have access to said safe and to receive and receipt for any special deposits which this corporation may at any time have on deposit with said Wells Fargo Bank & Union Trust Co. safe deposit vaults until advice to the contrary in writing be received by said Wells Fargo Bank & Union Trust Co.

On motion duly made and seconded, the following resolution was adopted by the vote of all Directors present:

Resolved, that the President be and he is hereby authorized and empowered to employ auditors to audit the books and records of the corporation.

Exhibit B-2 (Continued)

Director Wood then offered the following resolutions:

Whereas, various stockholders of this corporation and other parties have advanced and loaned moneys to this corporation between the 7th day of April, 1913, and the date of this resolution, the names of such parties and the original amounts loaned by them being as follows, to wit:

Name	Amounts Advanced
W. E. Dean	$14,833.50
Henry L. Middleton	1,658.50

And Whereas, this corporation has agreed to repay the said advances and loans, but the said advances and loans have not, nor has any part thereof, been repaid; and

Whereas, this corporation has agreed to pay interest on said amounts at the rate of six per cent per [35] annum from the date of the respective times when the same were advanced, and a portion of said interest, but not all thereof, has heretofore been paid; and

Whereas, all or portions of said indebtedness may become barred by the statute of limitations of the State of California, or the parties who loaned said amounts, their heirs, representatives, successors or assigns, may take action against the corporation to prevent the said amounts being barred by the said statute of limitations; and

Exhibit B-2 (Continued)

Whereas, it is the judgment of this Board of Directors that the said amounts of indebtedness and the whole thereof should be recognized by this corporation and appropriate documents executed by it and delivered to the proper parties acknowledging the respective amounts of said indebtedness due to them and agreeing to pay the same with unpaid interest thereon as aforesaid and waiving the provisions of the said statute of limitations;

Now, Therefore, Be It Resolved: That this corporation hereby acknowledges the existence of its aforesaid indebtedness and the respective amounts thereof hereinbefore recited as owing to the parties hereinbefore named, their heirs, representatives, successors or assigns, and that this corporation hereby agrees to pay the said respective amounts thereof, together with interest on such amounts at the rate of six per cent per annum from the dates upon which the respective amounts so advanced and loaned by said persons were received by this corporation as disclosed by its books, less such amount of interest as has heretofore been paid thereon; and

Be It Further Resolved, that the President or Vice President and Secretary of this corporation be, and they are hereby authorized and directed, for and on behalf of this corporation and as its corporate act and deed, to forward to each of said parties who loaned said money

Exhibit B-2 (Continued)

or their respective heirs, representatives, successors or assigns, a certified copy of this resolution, together with a letter signed by this corporation acknowledging the existence as of the date of this meeting, of the said indebtedness and of the said respective amounts thereof, together with interest thereon as hereinbefore in the preceding resolution set forth.

After discussion, upon motion duly made and seconded, the said resolutions last hereinbefore set forth were unanimously adopted by the vote of all Directors present.

(Thereupon Director Thorne offered the following resolutions:) [36]

Whereas, the Felton Company has advanced and loaned monies to this corporation at various times and in various amounts, between the 7th day of April, 1913, and the date of this resolution, the total amount of said original advances being $14,833.50; and

Whereas, this corporation has agreed to repay the said advances and the same have not, nor has any part thereof, been paid; and

Whereas, this corporation has agreed to pay interest on said amounts constituting said total of $14,833.50 at the rate of six per cent per annum from the date of the respective times when the same were advanced and a portion of said interest, but not all thereof, has heretofore been paid; and

Exhibit B-2 (Continued)

Whereas, all or portions of said indebtedness may become barred by the statute of limitations of the State of California or said The Felton Company may take action against the corporation to prevent the said amounts being barred by the said statute of limitations; and

Whereas, it is the judgment of this Board of Directors that the said amounts of indebtedness and the whole thereof should be recognized by this corporation and appropriate documents executed by it and delivered to said The Felton Company acknowledging the total amount of said indebtedness due to it and agreeing to pay the same with unpaid interest as aforesaid and waiving the provisions of the said statute of limitations;

Now, Therefore, Be It Resolved: That this corporation acknowledges the existence of its aforesaid indebtedness to The Felton Company aggregating in the principal amount the sum of $14,833.50 and that this corporation agrees to pay the same, together with interest thereon at the rate of six per cent per annum from the dates upon which the respective amounts thereof so advanced by said The Felton Company were received by this corporation as disclosed by its books, less such amount of interest as has heretofore been paid thereon; and

Be It Further Resolved, that the President and Secretary of this corporation be and they are hereby authorized and directed for and on

Exhibit B-2 (Continued)

behalf of this corporation and as its corporate act and deed to forward to the said The Felton Company a certified copy of this resolution, together with a letter signed by this corporation acknowledging the existence as of the date of this meeting of the said indebtedness aggregating $14,833.50 together with interest thereon as hereinbefore in the preceding resolution set forth. [37]

Mr. Wood stated and disclosed that he was interested in the said resolutions through his representation of The Felton Company interests and requested the fact of such interest and of his participation to be noted in the minutes, and upon motion duly made, seconded and carried, it was ordered that this notation be made.

Thereupon on motion duly made and seconded, the said resolutions last hereinbefore set forth were unanimously adopted by the vote of all Directors present.

Thereupon Director Wood offered the following resolutions:

Whereas, W. S. Thorne, deceased, advanced and loaned monies to this corporation at various times and in various amounts, between the 7th day of April, 1913 and the date of this resolution, the total amount of said original advances being $255.00; and

Whereas, this corporation has agreed to repay the said advances and the same have not, nor has any part thereof, been paid; and

Exhibit B-2 (Continued)

Whereas, this corporation has agreed to pay interest on said amounts constituting said total of $255.00 at the rate of six per cent per annum from the date of the respective times when the same were advanced and a portion of said interest, but not all thereof, has heretofore been paid; and

Whereas, all or portions of said indebtedness may become barred by the statute of limitations of the State of California or the representative or representatives, assign or assigns, of said W. S. Thorne may take action against the corporation to prevent the said amounts being barred by the said statute of limitations; and

Whereas, it is the judgment of this board of directors that the said amounts of indebtedness and the whole thereof should be recognized by this corporation and appropriate documents executed by it and delivered to the proper persons asknowledging the total amount of said inbedtedness due to said W. S. Thorne and agreeing to pay the same with unpaid interest as aforesaid and waiving the provisions of the said statute of limitations;

Now, Therefore, Be It Resolved: That this corporation acknowledges the existence of its aforesaid indebtedness to W. S. Thorne aggregating in the principal amount the sum of $255.00 and that this corporation agrees to pay the same, together with interest thereon

Exhibit B-2 (Continued)

at the rate of six per cent per annum from the dates upon which the respective amounts thereof so advanced by said W. S. Thorne were received by this corporation as disclosed by its books, less such amount of interest as has heretofore been paid thereon; and

Be It Further Resolved, that the President or Vice President and Secretary of this corporation be and they are hereby authorized and directed for and on behalf of this corporation and as its corporate act and deed to forward to the representative or representatives, assign or assigns of said W. S. Thorne a certified copy of this resolution together with a letter signed by this corporation acknowledging the existence as of the date of this meeting of the said indebtedness aggregating $255.00, together with interest thereon as hereinbefore in the preceding resolution set forth. [38]

Mr. Andrew Thorne stated and disclosed that he was interested in the said resolutions as one of the heirs of W. S. Thorne, deceased, and requested the fact of such interest and of his participation to be noted in the minutes, and upon motion duly made, seconded and carried, it was ordered that this notation be made.

Thereupon on motion duly made and seconded, the said resolutions last hereinbefore set forth were unanimously adopted by the vote of all Directors present.

Exhibit B-2 (Continued)

Director Andrew Thorne thereupon offered the following resolutions:

Whereas, Timothy Hopkins has advanced and loaned monies to this corporation at various times and in various amounts, between the 7th day of April, 1913, and the date of this resolution, the total amount of said original advances being $35,270.25; and

Whereas, this corporation has agreed to repay the said advances and the same have not, nor has any part thereof, been paid; and

Whereas, this corporation has agreed to pay interest on said amounts constituting said total of $35,270.25 at the rate of six per cent per annum from the date of the respective times when the same were advanced and a portion of said interest, but not all thereof, has heretofore been paid; and

Whereas, all or portions of said indebtedness may become barred by the statute of limitations of the State of California or said Timothy Hopkins may take action against the corporation to prevent the said amounts being barred by the said statute of limitations; and

Whereas, it is the judgment of this board of directors that the said amounts of indebtedness and the whole thereof should be recognized by this corporation and appropriate documents executed by it and delivered to said Timothy Hopkins acknowledging the total amount of said indebtedness due to him and agreeing to

Exhibit B-2 (Continued)

pay the same with unpaid interest as aforesaid and waiving the provisions of the said statute of limitations;

Now, Therefore, Be It Resolved: That this corporation acknowledges the existence of its aforesaid indebtedness to Timothy Hopkins aggregating in the principal amount the sum of $35,270.25 and that this corporation agrees to pay the same, together with interest thereon at the rate of six per cent per annum from the dates upon which the respective amounts thereof so advanced by said Timothy Hopkins were received by this corporation as disclosed by its books, less such amount of interest as has heretofore been paid thereon; and [39]

Be It Further Resolved: That the Vice President and Secretary of this corporation be and they are hereby authorized and directed for and on behalf of this corporation and as its corporate act and deed to forward to the said Timothy Hopkins a certified copy of this resolution together with a letter signed by this corporation acknowledging the existence as of the date of this meeting of the said indebtedness aggregating $35,270.25 together with interest thereon as hereinbefore in the preceding resolution set forth.

Mr. Hopkins stated and disclosed that he was interested in the said resolutions as the creditor therein named and requested the fact of such interest and of his participation to be noted in the

Exhibit B-2 (Continued)

minutes, and upon motion duly made, seconded and carried, it was ordered that this notation be made.

Thereupon on motion duly made and seconded, the said resolutions last hereinbefore set forth were unanimously adopted by the vote of all Directors present.

On motion duly made and seconded, the following resolutions were adopted by the vote of all Directors present:

> Resolved, that the office of this corporation be and it is hereby changed from No. 905 Kohl Building, San Francisco, California, to No. 2005, One Eleven Sutter Street, San Francisco, California; and
>
> Further Resolved, that said last mentioned address be and it is hereby adopted as the principal office of this corporation at which meetings of stockholders and directors shall henceforth be held, except as otherwise permitted by law and the by-laws of this corporation.

There being no further business, on motion duly made, seconded and carried, the meeting was adjourned.

[Signed] P. A. WOOD,
Secretary of the Meeting.

We hereby certify that the foregoing minutes are correct.

[Signed] TIMOTHY HOPKINS
[Signed] ANDREW THORNE
[Signed] P. A. WOOD [40]

Exhibit B-2 (Continued)

Minutes of Special Meeting
of the Board of Directors of

WESTERN SHORE LUMBER COMPANY

San Francisco, California,
August 8, 1933.

Pursuant to call by the President and written notice as hereinafter set forth, a special meeting of the Board of Directors of Western Shore Lumber Company, a corporation, was held at the office of the corporation at Room 2005, 111 Sutter Street, San Francisco, California, on Tuesday, the 8th day of August 1933, at the hour of 11 o'clock A. M. The following directors were present, constituting a quorum:

Timothy Hopkins
A. Crawford Greene
Percy A. Wood
Andrew Thorne

President Hopkins presided, and Secretary Lane acted as secretary of the meeting.

The President's call was presented and, on motion duly made and seconded, was made a part of the records of the meeting. Said call is as follows:

Call for Special Meeting of
The Board of Directors of

WESTERN SHORE LUMBER COMPANY

A special meeting of the Board of Directors of Western Shore Lumber Company is hereby called

Exhibit B-2 (Continued)

to be held at the office of the corporation, Room 2005, 111 Sutter Street, San Francisco, California, on Tuesday, the 8th day of August, 1933, at 11:00 o'clock A. M., for the purpose of considering and acting upon the election of a director to succeed Mr. Walter L. Dean, deceased, and for the purpose of considering and acting upon any and all other business which may come before the meeting.

The Secretary of the corporation is hereby directed to give notice of said meeting in accordance with the by-laws of the corporation.

[Signed] TIMOTHY HOPKINS,
President.

Dated: San Francisco, California, August 2, 1933.

The secretary reported that in accordance with the foregoing call, and in accordance with the by-laws of the corporation, she had deposited with postage thereon prepaid, in the United States mail at San Francisco, California, a notice of the meeting, addressed to each director at his place of business or residence as known to the Secretary, at least thirty-six hours before the time fixed for the holding of the meeting, namely, on the 2nd day of August, 1933. The Secretary presented to the meeting a copy of the notice so mailed by *him* to each of the directors, and on motion duly made and seconded said copy was made a part of the records of the meeting. Said copy is as follows: [41]

Exhibit B-2 (Continued)

Notice of Special Meeting of
Board of Directors of

WESTERN SHORE LUMBER COMPANY

Notice is hereby given that a special meeting of the Board of Directors of Western Shore Lumber Company has been called by the President to be held, and will be held at the office of the corporation, Room 2005, 111 Sutter Street, San Francisco, California, on Tuesday, the 8th day of August, 1933, at 11 o'clock A. M., for the purpose of considering and acting upon the election of a director to succeed Mr. Walter L. Dean, deceased and for the purpose of considering and acting upon any and all other business which may come before the meeting.

[Signed] MYRA LANE,
Secretary of Western Shore
Lumber Company.

Dated at San Francisco, California, August 2, 1933.

The President announced that there was a vacancy in the Board and called for nominations. Mr. Greene moved, seconded by Mr. Wood, that Mr. Walter Edwin Dean be elected a Director of this corporation, and upon the motion being put, Mr. Dean was unanimously elected and being present, took his seat.

The Secretary read the minutes of the previous meeting held on the 5th day of July, 1933. On motion of Director Greene, duly seconded, the said

Exhibit B-2 (Continued)

minutes were unanimously ratified and approved as read, with the following modifications:

On Page 69, the lines "Mr. Andrew Thorne stated and disclosed that he was interested in the said resolutions as one of the heirs of W. S. Thorne, deceased," should read—"Mr. Andrew Thorne stated and disclosed that he was interested in the said resolutions as executor of the estate of W. S. Thorne, deceased."

On Page 65, the resolutions providing for banking arrangements with the Wells Fargo Bank & Union Trust Company in relation to withdrawal of money and access to safe deposit vault, the lines—"A. Crawford Greene, Vice President, alone," should read "— "A. Crawford Greene, Vice President, and Myra Lane, Secretary, together."

After a discussion of the financial condition of the corporation, upon motion the President and Secretary were instructed to pay the interest semi-annually beginning August 15, 1933, upon loans made to this corporation by its stockholders.

The Directors also decided that it would be to the best interests of *the best interests of* the Company to maintain a reserve to provide against future expenses, and the President reported that at present there was $33,592.86 in the savings bank for this purpose.

There being no further business, on motion duly made, seconded and carried, the meeting adjourned.

[Signed] MYRA LANE,

Secretary of the Meeting. [42]

Exhibit B-2 (Continued)

WESTERN SHORE LUMBER COMPANY
San Francisco, California

BALANCE SHEETS

Assets

	Jan. 1-33	Dec. 31-33
Cash	$ 36,458.26	44,390.09
Timber	1,491,412.71	1,474,970.01
Real Estate	66,195.55	66,195.55
Buildings	1,250.98	1,250.98
Total	1,595,317.50	1,586,806.63

Liabilities

Deposit on Stumpage	40,000.00	40,000.00
Stockholders' Loans	66,850.75	60,165.68
Common Capital Stock	1,000,000.00	1,000,000.00
Surplus & Appreciation Reserves	488,466.75	486,640.95
Total	1,595,317.50	1,586,806.63

[43]

[On the original there is here inserted a copy of Agreement. Copy of this Agreement appears in the Claim for Refund for the year 1933.]

[44]

EXHIBIT No. B-3

Form 843
Treasury Department
Internal Revenue Service
Revised June 1930

To Be Filed in Duplicate

CLAIM

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the

kind of claim filed, and fill in the certificate on the reverse side.

☐ Refund of Tax Illegally Collected.

☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

☐ Abatement of Tax Assessed (not applicable to estate or income taxes).

Collector's Stamp (Date received)

State of California
City and County of San Francisco—ss.

Type or Print.

Name of taxpayer or purchaser of stamps—Western Shore Lumber Company.

Business address—403 Merchants Exchange Building, San Francisco, California.

Residence—

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named. and that the facts given below are true and complete:

1. District in which return (if any) was filed—First District, California.

2. Period (if for income tax, make separate form for each taxable year)—Year ending June 30, 1935.

3. Character of assessment or tax—Capital stock tax.

4. Amount of assessment, $24.00; dates of payment—July 31, 1935.

5. Date stamps were purchased from the Government—

6. Amount to be refunded—$24 with interest thereon at the rate of 6%.

7. Amount to be abated (not applicable to income or estate taxes)—

8. The time within which this claim may be legally filed does not expire prior to July 31, 1939 (See Revised Stats. Sec. 3228, as amended.)

The deponent verily believes that this claim should be allowed for the following reasons:

(For statement of grounds for refund, see pages attached hereto and hereby made a part hereof.)

(Attach letter-size sheets if space is not sufficient)

WESTERN SHORE LUMBER COMPANY

[Signed] By FRANK C. NELSON
Secretary

Sworn to and subscribed before me this 27th day of August 1937.

[Notarial Seal] FRANK L. OWEN
Notary Public in & for the city & county of San Francisco, State of California.

(See Instructions on Reverse Side)

(See Instructions on Reverse Side) [45]

CERTIFICATE

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax: Character of assessment and period covered, List, Year, Month, Account No. or Page, Line, Amount assessed, $_____. Total, $_____.

Paid, Abated, or Credited, Date, Amount, $------.
Total, $------.

Claim No.-------.

I certify that the records of this office show the following facts as to the purchase of stamps: To Whom Sold or Issued, Kind, Number, Denomination, Date of sale or issue, Amount, $............

If special tax stamp, state: Serial number, Period commencing—.

...., ...

Collector of Internal Revenue. (District)

Committee on Claims

Claim examined by—------.

Claim approved by—------. Chief of Division.

Amount claimed... $------.

Amount allowed-- $------.

Amount rejected-- $------.

INSTRUCTIONS

1. The claim must be set forth in detail and under oath each gorund upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of

the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

[On the original there is here inserted a copy of Statement of Facts. Copy of this Statement of Facts appears in the Claim for Refund for the year 1933.] [46]

WESTERN SHORE LUMBER COMPANY

CASH RECEIPTS AND DISBURSEMENTS

July 1, 1934 to June 30, 1935

Receipts

Receipts under Stumpage Contract with Santa Cruz Lumber Co.			$ 4,625.93
Interest—Special Savings Account with Wells Fargo Bank & Union Trust Co.			562.05
Sale of Equipment			50.00
			5,237.98

Disbursements

Interest on Loans			4,243.94
Taxes			4,310.22
Timber Lands		4,259.56	
San Mateo County	3,957.17		
Santa Cruz County	302.39		
Federal Capital Stock		25.00	
State Franchise		25.00	
Federal Check		.66	
Trail Maintenance			1,800.00
Secretarial Expense			300.00
General Expenses			274.00
Office Rent		240.00	
Compensation Insurance		32.00	
Miscellaneous		2.00	
			10,928.16
Excess Disbursements Over Receipts			5,690.18
Balance Cash July 1, 1934			41,402.66
Wells Fargo Bank & Union Trust Co.—Savings Account		34,434.42	
Wells Fargo Bank & Union Trust Co.—Commercial Account		6,968.24	
Balance Cash June 30, 1935			35,712.48
Wells Fargo Bank & Union Trust Co.—Savings Account		34,996.47	

Wells Fargo Bank & Union Trust Co.— Commercial Account	716.01

[47]

No Minutes of Meetings of Board of Directors for Year July 1, 1934 to June 30, 1935 [48]

WESTERN SHORE LUMBER COMPANY
San Francisco, California

BALANCE SHEETS

Assets

	Jan. 1-34	Dec. 31-34
Cash	$ 44,390.09	41,311.10
Timber	1,474,970.01	1,457,497.98
Real Estate	66,195.55	66,195.55
Buildings	1,250.98	1,250.98
Total	1,586,806.63	1,566,255.61

Liabilities

Deposit on Timber Purchase	40,000.00	27,479.08
Accounts Payable		1,157.44
Stockholders' Loans	60,165.68	51,441.70
Common Capital Stock	1,000,000.00	1,000,000.00
Surplus & Appreciation Reserves	486,640.95	486,177.39
Total	1,586,806.63	1,566,255.61

[49]

[On the original there is here inserted a copy of Agreement. Copy of this Agreement appears in the Claim for Refund for the year 1933.] [50]

EXHIBIT No. B-4

Form 843
Treasury Department
Internal Revenue Service
Revised June 1930

To Be Filed in Duplicate

CLAIM

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

☐ Refund of Tax Illegally Collected.

☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

☐ Abatement of Tax Assessed (not applicable to estate or income taxes).

Collector's Stamp (Date received)

State of California
City and County of San Francisco—ss.

Type or Print.

Name of taxpayer or purchaser of stamps—Western Shore Lumber Company.

Business address—403 Merchants Exchange Building, San Francisco, California.

Residence—

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed—First District, California.

2. Period (if for income tax, make separate form for each taxable year)—Year ending June 30, 1936.

3. Character of assessment or tax—Capital stock tax.

4. Amount of assessment, $1,000; dates of payment—September 18, 1936.

5. Date stamps were purchased from the Government—

6. Amount to be refunded—$1,000 with interest thereon at the rate of 6%.

7. Amount to be abated (not applicable to income or estate taxes)—

8. The time within which this claim may be legally filed does not expire prior to Sept. 18, 1940 (See Revised Stats. Sec. 3228, as amended.)

The deponent verily believes that this claim should be allowed for the following reasons:

(For statement of grounds for refund, see pages attached hereto and hereby made a part hereof.)

(Attach letter-size sheets if space is not sufficient)

WESTERN SHORE LUMBER COMPANY

[Signed] By FRANK C. NELSON
Secretary

Sworn to and subscribed to before me this 27th day of August 1937.

[Notarial Seal] FRANK L. OWEN
Notary Public in & for the city & county of San Francisco, State of California.

(See Instructions on Reverse Side) [51]

CERTIFICATE

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax: Character of assessment and period covered, List, Year, Month, Account No. or Page, Line, Amount Assessed, $..............

Total, $______.

Paid, Abated, or Credited Date, Amount $______.

Total, $______.

Claim No. ______.

I certify that the records of this office show the following facts as to the purchase of stamps: To Whom Sold or Issued, Kind, Number, Denomination, Date of sale or issue, Amount $______.

If special tax stamp, state: Serial number Period commencing—.

...., ...

Collector of Internal Revenue. (District)

Committee on Claims

____

____

____

Claim examined by—______.

Claim approved by—______Chief of Division.

Amount claimed__ $______.

Amount allowed... $______.

Amount rejected__ $______.

INSTRUCTIONS

1. The claim must set forth in detail and under oath each ground upon which it is made, and facts sufficient to apprise the Commissioner of the exact basis thereof.

2. The claim should be sworn to by the taxpayer, if possible. Whenever it is necessary to have the claim executed by an attorney or agent, on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent or attorney to sign the claim on behalf of the taxpayer shall accompany the claim. The oath will be administered without charge by any collector, deputy collector, or internal revenue agent.

3. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

4. Where the taxpayer is a corporation, the claim shall be signed with the corporate name, followed by

the signature and title of the officer having authority to sign for the corporation.

[On the original there is here inserted a copy of Statement of Facts. Copy of this Statement of Facts appears in the Claim for Refund for the year 1933.] [52]

WESTERN SHORE LUMBER COMPANY

CASH RECEIPTS AND DISBURSEMENTS
July 1, 1935 to June 30, 1936

Receipts

Receipts under Stumpage Contract with Santa Cruz Lumber Co.			$ 9,404.54
Interest—Special Time Deposit with Wells Fargo Bank & Union Trust Co.			165.58
Sale of Junk			158.38
Total Receipts			9,728.50

Disbursements

Taxes			4,909.05
Timber Lands		4,719.32	
San Mateo County	4,449.70		
Santa Cruz County	269.62		
Federal Income Tax (½ Year)		104.14	
State Franchise Tax		61.59	
Federal Capital Stock		24.00	
Interest on Loans			3,086.50
Trail Maintenance			1,800.00
Secretarial Expense			300.00
General Expenses			322.00
Office Rent		240.00	
Repairs		48.00	
Compensation Insurance		32.00	
Miscellaneous		2.00	
Total Disbursements			10,417.55

Disbursements—(Continued)

Excess Disbursements Over Receipts		689.05
Balance Cash July 1, 1935		35,712.48
Wells Fargo Bank & Union Trust Co.— Savings Account	34,996.47	
Wells Fargo Bank & Union Trust Co.— Commercial Account	716.01	
Balance Cash June 30, 1936		35,023.43
Wells Fargo Bank & Union Trust Co.— Savings Account	32,162.05	
Wells Fargo Bank & Union Trust Co.— Commercial Account	2,861.38	

[53]

WESTERN SHORE LUMBER COMPANY

Copies of Minutes of Meetings of Board of Directors

July 1, 1935 to June 30, 1936

Minutes of Special Meeting of the Board of Directors of Western Shore Lumber Company

San Francisco, California,
February 18, 1936.

Pursuant to call by Directors A. Crawford Greene and Percy A. Wood and written notice as hereinafter set forth, a special meeting of the Board of Directors of Western Shore Lumber Company, a corporation, was held at the office of the corporation at room 2005, 111 Sutter Street, San Francisco, California, on Tuesday, the 18th day of February, 1936, at the hour of 3:00 o'clock P.M. The following directors were present, constituting a quorum:

Messrs. A. CRAWFORD GREENE
PERCY A. WOOD
ANDREW THORNE

Absent: Mr. Walter Edwin Dean II.

Vice-President Greene presided and Secretary Lane acted as secretary of the meeting.

The Directors' call was presented and, on motion duly made and seconded, was made a part of the records of the meeting. Said call is as follows:

Call for Special Meeting of Board of Directors
of
Western Shore Lumber Company

The undersigned, A. Crawford Greene and Percy A. Wood, constituting two of the directors of Western Shore Lumber Company, hereby call a special meeting of the Board of Directors of said corporation in accordance with the by-laws, to be held at its office, Room 2005, 111 Sutter Street, San Francisco, California, on Tuesday, the 18th day of February, 1936, at 3:00 o'clock P.M., for the purpose of considering and acting upon any and all business which may come before said meeting.

The Secretary of the corporation is hereby directed to give notice of said meeting in accordance with the by-laws.

[Signed] PERCY A. WOOD
" A. CRAWFORD GREENE
Directors of
WESTERN SHORE LUMBER COMPANY

Dated: February 14, 1936. [54]

The Secretary reported that in accordance with the foregoing call, and in accordance with the by-laws of the corporation, she had deposited with postage thereon prepaid, in the United States mail at San Francisco, California, a notice of the meeting, addressed to each director at his place of business or residence as known to the Secretary, at least thirty-six hours before the time fixed for the holding of the meeting, namely on the 18th day of February, 1936. The Secretary presented to the meeting a copy of the notice so mailed by her to each of the directors, and on motion duly made and seconded said copy was made a part of the records of the meeting. Said copy is as follows:

Notice is hereby given that a special meeting of the Board of Directors of Western Shore Lumber Company has been called by two of the directors, pursuant to the by-laws, to be held, and that said meeting will be held, at the office of the company, Room 2005, 111 Sutter Street, San Francisco, California, on Tuesday, the 18th day of February, 1936, at 3:00 o'clock P.M., for the purpose of considering and acting upon any and all business which may come before the meeting.

[Signed] MYRA LANE
Secretary of
WESTERN SHORE LUMBER COMPANY

Dated: February 14, 1936.

The Vice President called for the reading of the minutes of the previous meeting held on the 8th day of August, 1933. On motion duly made, seconded and

carried the said minutes were approved as read.

Vice President Greene announced that there was a vacancy in the Board and called for nominations. Mr. Wood nominated Mr. J. A. Ducournau, and there being no further nominations, on motion of Mr. Wood, seconded by Mr. Thorne, Mr. Ducournau was duly elected and, being present, took his seat with the other directors present.

Mr. Greene further announced that nominations were in order for the office of President of the corporation. Mr. Thorne nominated Mr. Percy A. Wood, and there being no further nominations, upon motion of Mr. Thorne, seconded by Mr. Ducournau, Mr. Wood was unanimously elected the President of this corporation.

Vice President Greene reported that he had recently signed, with the approval of Mr. Wood, a supplemental agreement between this corporation and the Santa Cruz Lumber Company. The Secretary presented said agreement, dated January 17, 1936, being supplemental to the agreement of March 10, 1930, with the said Santa Cruz Lumber Company, and allowing them to cut, fell and remove certain timber on lands of this corporation in

East ½ and the East ½ of the West ½ of Section 22, Township 8 South, Range 3 West

at the price of Two Dollars ($2.00) per thousand feet board measure. On motion, duly made and seconded, it was unanimously voted that the action of the Vice President and Secretary in executing the above said supplemental agreement be ratified, confirmed and approved. [55]

The Secretary reported Cash in Bank as of this date in the amount of $38,215.71. A financial statement for the year ending December 31, 1935, was also presented by the Secretary, a copy of which follows.

WESTERN SHORE LUMBER COMPANY

STATEMENT

December 31, 1935

Assets

Cash in Bank			$33,546.38
Land—13,239 Acres at $5			66,195.55
Redwood Timber		1,380,877.26	
Reserve for Depletion		90,255.06	1,290,622.20
Pine Timber		84,622.50	
Reserve for Depletion		10,658.46	73,964.04
Tan Bark		75,230.40	
Reserve for Depletion		1,480.73	73,749.67
Road Building			1,250.98
Mill Construction	4,823.78		
Water Works	1,664.58		
Logging Equip. & Machinery	5,731.62	12,219.98	
Less Reserve for Depreciation		12,219.98	
			1,539,328.82

Liabilities

Assessments—Stockholders		37,500.00	
Loans Payable—Stockholders		51,441.70	
Accounts Payable		195.00	
Capital Surplus from Appreciation	608,303.51		
Less Balance Acct.	158,111.39	450,192.12	
Capital Stock		1,000,000.00	1,539,328.82

WESTERN SHORE LUMBER COMPANY

INCOME AND EXPENSES
1935

Income			
Sales of Timber		30,649.14	
Sales of Old Machinery		50.00	
Interest on Special Savings Acct.		300.70	30,999.84
Expenditures			
Interest on Loans		3,086.50	
Salary—Caretaker		1,500.00	
Horse Feed—Bennett		300.00	
Tallyman Expense		300.00	
Office Rent		240.00	
Salary—Secretary		300.00	
Expenses—Bennett		24.00	
Compensation Insurance Premiums		32.00	
Notary Fees		2.00	
Taxes Paid:			
Real Estate	4,489.44		
State Franchise	25.00		
Federal Capital Stock	24.00		
Federal Excise	.10	4,538.54	10,323.04
			20,676.80
Timber Depletion			11,725.75
Balance			8,951.05

[56]

On motion duly made and seconded the following resolution was adopted by the vote of all Directors present:

Resolved: That the President, Percy A. Wood, and Secretary, Myra Lane, of this corporation, or the Vice President, A. Crawford Greene and the Secretary, Myra Lane, are jointly authorized to sign the name of this Corporation to Checks, Drafts, Bills of Exchange, Receipts, Acceptances and Acquit-

tances and to endorse its name on Checks, Drafts, Bills of Exchange, Notes and other evidences of indebtedness, and the President shall have the power to confer the authority hereby given him on other Officers and Agents of the Corporation as may, in his judgment, be necessary to facilitate its business.

Motion was duly made, seconded and carried that the office of this Corporation be and it is hereby changed from Room 2005 to Room 1812, Number 111 Sutter Street, San Francisco, California.

There being no further business, on motion duly made, seconded and carried, the meeting adjourned.

[Signed] MYRA LANE

Secretary. [57]

WESTERN SHORE LUMBER COMPANY
San Francisco, California

BALANCE SHEETS

Assets

	Jan. 1-35	Dec. 31-35
Cash	$ 41,311.10	33,546.38
Timber	1,457,497.98	1,438,335.91
Real Estate	66,195.55	66,195.55
Buildings	1,250.98	1,250.98
Total	1,566,255.61	1,539,328.82

Liabilities

Deposit on Timber Purchase	27,479.08	
Accounts Payable	1,157.44	195.00
Stockholders' Loans	51,441.70	51,441.70
Common Capital Stock	1,000,000.00	1,000,000.00
Surplus & Appreciation Reserves	486,177.39	487,692.12
Total	1,566,255.61	1,539,328.82

[58]

[On the original there is here inserted a copy of Agreement. Copy of this Agreement appears in the Claim for Refund for the year 1933.] [59]

EXHIBIT C

TREASURY DEPARTMENT
Washington

Office of
Commissioner of Internal Revenue

Jan. 26, 1938

Address Reply to
Commissioner of Internal Revenue
And Refer to
MT: CST: CFP 161541
Cls: CST-53148, 53149, 63859, 82564
Western Shore Lumber Company,
4 Montgomery Street
San Francisco, California.

Gentlemen:

Consideration has been given to your claims filed for the refund of $1,250.00, $25.00, $24.00, and $1,000.00 representing the capital stock tax liability paid for the taxable years ended June 30, 1933, June 30, 1934, June 30, 1935, and June 30, 1936, respectively.

The claims are based on the contention that the corporation is a holding company and that it has not engaged in business activities for the years

involved within the meaning of the law and regulations, and therefore it is not subject to capital stock tax.

The evidence of record discloses that an agreement was made by your corporation on April 23, 1929, with the Santa Cruz Lumber Company, whereby the second party acquired the right to cut, fell and remove the redwood and pine timber and the tanbark from the timber lands of the first party according to certain provisions. The evidence also discloses that your corporation retained the right to employ a tallyman mutually agreed upon by both parties, or appointed by your corporation and the expenses of the employment of the tallyman be divided between the parties concerned. The determination of the amount of tanbark cut by the second party was also determined by a person either elected by your corporation or agreed upon by both parties and the expense of the employment of such person was borne equally by both parties. Your corporation also retained the right at any time to inspect the operations of the second party on the said timber lands and the method of tallying provided for and also to examine the books of account of the second party and all other records covering the operations on the timber lands involved in the agreement. The evidence also reveals that the agreement was only for a term of two years which indicates that any timber removed after 1931 was done under an oral agreement. [60]

Under the law and regulations a holding company

is defined as one whose corporate powers are limited to the mere holding of property and distribution of its avails, or one which, although incorporated for the purpose of doing business, has retired from the business for which it was organized and has reduced its activities to the mere ownership and holding of the property, distributing its avails and doing only such acts as are necessary for the maintenance of its corporate existence and to the private management of its purely internal affairs. If a corporation should go beyond the limitations stated above and engage in any business activities at any time, the tax will attach.

In view of the foregoing provisions of the law and regulations and inasmuch as the evidence clearly shows that the property was not entirely out of control of your corporation but under the agreement was subject to its supervision, it is held that your corporation during the years involved, engaged in activities in excess of those of a dormant holding company and therefore is not exempt from capital stock tax.

Your claims for refund are therefore rejected in full.

Respectfully,

GUY T. HELVERING,

Commissioner

By D. S. BLISS,

Deputy Commissioner [61]

No. 3688

C. F. Curry, Secretary of State J. Hoesch, Deputy

STATE OF CALIFORNIA
DEPARTMENT OF STATE—ss.

I. C. F. Curry, Secretary of State of the State of California, do hereby certify that I have carefully compared the annexed copy of Articles of Incorporation of Western Shore Lumber Company with the certified copy of the original now on file in my office, and that the same is a correct transcript therefrom, and of the whole thereof. Also that this authentication is in due form and by the proper officer.

Witness my hand and the Great Seal of State, at office in Sacramento, California, the 2nd day of July, A. D. 1906.

[SEAL] C. F. CURRY
Secretary of State.
By J. HOESCH
Deputy. [62]

EXHIBIT D

ARTICLES OF INCORPORATION
of the
WESTERN SHORE LUMBER COMPANY

Know All Men By These Presents:

That we, the undersigned, a majority of whom are citizens and residents of the State of California, have this day voluntarily associated ourselves to-

gether for the purpose of forming a corporation under the laws of the State of California, and we hereby certify:

First: That the name of the Corporation shall be: Western Shore Lumber Company.

Second: That the purposes for which said corporation is formed are:

(a) To engage in and carry on in all their branches a general lumber, mercantile, commercial, commission, manufacturing, trading, transportation, water, lighting, power, storage and investment business; to acquire in any manner, or to any extent, in any part of the world, or by construction, purchase, condemnation, exchange, location, appropriation, or otherwise, or in any manner whatsoever to receive, own, hold, use, operate, lease, supply, mortgage, sell, or otherwise acquire, hold or dispose of, lands, timber, lumber, wood, bark, water, water rights, power, electric and otherwise, railroads, wagon roads, skid roads, plank roads, turnpike roads, or any other kind of roads, power transmission plants, sawmills, bridges, aqueducts, ferries wharves, chutes, piers, canals, flumes, ditches, steamboats, or any other kind of boats, stores, boarding houses, mills, factories, pipe lines, reservoirs and reservoir sites, dams, dam sites, pole lines, telegraph and telephone plants, patents, patent rights, franchises, securities, investments, or any other kind of property, real, personal or mixed; to

apply for, obtain register, lease, or otherwise acquire, and to hold, use, operate, sell, assign, or otherwise dispose of any trade mark, trade names, patents, inventions, improvements and processes, used in connection with or secured under letters of the United States or of any other country or countries, or otherwise; and to use, exercise, develop, grant, license or otherwise turn to account any such trade marks, trade names, patents, inventions, improvements and processes and the like, or any property rights or inventions so acquired, and with a view to the working and development of the same to carry on any business which the Board of Directors then in office may from time to time deem calculative directly or indirectly to effectuate these objects or any of them. To acquire the good will and property of all kinds and to pay for the same in cash, stocks or bonds of this corporation. To purchase, lease, hire exchange or otherwise acquire any and all rights, privileges, permits or franchises suitable or convenient for any of the purposes of the business of this corporation, and to carry on a general business and act as fully in all matters of business as a natural person might or could do, and in any part of the world act as principal agent or otherwise; and pledge any property which may be acquired by it.

(b) To contribute in any manner to the expense of promoting, constructing, acquiring,

improving or maintaining, any work, of any king, howsoever owned; to buy, acquire, hold, guaranty, pledge or contract with reference to, or otherwise dispose of, in any manner whatsoever, shares, bonds, obligations, or other securities of this or of [63] any other corporations, or of firms or of individuals; to borrow, receive on deposit, or otherwise, or lend moneys; and issue bonds and other obligations in payment for property purchased or acquired by it, for moneys borrowed or for any other lawful object in and about its business.

(c) To promote, do, acquire, hold or dispose of all or anything incident to or necessary, suitable, convenient or proper to carry out any of the matters, things or purposes aforesaid, or incidental thereto, or the attainment of any one or more of the objects herein enumerated, or which in the judgment of the Board of Directors then in office may be deemed or declared by it, by By-laws, resolution or otherwise, to be necessary, useful, incidental or auxiliary to any of the purposes of the corporation, or to tend to advance the interests of the Company directly or indirectly, or for the protection, advantage, benefit and use of the corporation.

Third: That the place where the principal business of said corporation is to be transacted in the City and County of San Francisco, State of California.

Fourth: That the term for which said corporation is to exist is Fifty (50) years from the date of its incorporation.

Fifth: That the number of Directors of said corporation shall be five (5), and that the names and residences of its directors who are to serve until the election and qualification of their successors are as follows; to wit:

Names	Whose Residence Is at	
Timothy Hopkins,	Menlo Park,	California.
H. L. Middleton,	Boulder Creek,	California.
J. S. Severence,	San Francisco,	California.
William B. McKinnon,	San Mateo,	California.
William H. Middleton,	San Francisco,	California.

Sixth: That the amount of the Capital Stock of the said corporation is one million (1,000,000) dollars, and the number of shares into which it is divided is ten thousand (10,000) shares of the par value of one hundred (100) dollars each.

Seventh: That the amount of said Capital Stock which has been actually subscribed is five hundred (500) dollars, and that the following are the names of the persons by whom the same has been subscribed.

Names	Number of Shares	Amount
Timothy Hopkins	one	$100.
H. L. Middleton	one	$100.
J. S. Severence	one	$100.
William B. McKinnon	one	$100.
William H. Middleton	one	$100.

In Witness Whereof, we have hereunto set our hands this 18th day of November, 1905.

TIMOTHY HOPKINS
H. L. MIDDLETON
J. S. SEVERENCE
WM. B. McKINNON
WILLIAM H. MIDDLETON

[64]

State of California,
City and County of San Francisco—ss.

On this 18th day of November, A.D. one thousand nine hundred and five, before me, Mark Lane, a Notary Public in and for the City and County of San Francisco, personally appeared Timothy Hopkins, H. L. Middleton, J. S. Severence, William B. McKinnon, and William H. Middleton, known to me to be the persons whose names are subscribed to the within instrument and acknowledged to me that they executed the same.

In Witness Whereof I have hereunto set my hand and affixed my official seal the day and year in the certificate first above written.

[Notarial Seal] MARK LANE,
Notary Public in and for the City and County of San Francisco, State of California.

State of California,
City and County of San Francisco—ss.

I, John J. Greif, County Clerk of the City and County of San Francisco, State of California, hereby certify the foregoing to be a full, true and correct copy of the original Articles of Incorporation

of Western Shore Lumber Company filed in my office on the 20th day of November, A.D. 1905.

Attest my hand and my official seal this 20th day of November, A.D. 1905.

[Seal] JOHN J. GREIF
County Clerk.
By CHAS. C. MORRIS,
Deputy County Clerk.

[Endorsed]: Filed in the office of the County Clerk of the City and County of San Francisco, State of California, this 20th day of Nov. A.D. 1905.

JOHN J. GREIF
County Clerk.
By CHAS. C. MORRIS
Deputy Clerk.

[Endorsed]: Filed in the office of the Secretary of State, the 21st day of Nov. A.D. 1905.

C. F. CURRY
Secretary of State.
By J. HOESCH
Deputy.

Recorded Book 180, Page 223.

[Endorsed]: Filed Nov. 30, 1939. [65]

[Title of District Court and Cause.]

ANSWER

Now comes the defendant, appearing by its Attorney, Frank J. Hennessy, United States Attorney

for the Northern District of California, and answers the complaint on file herein as follows:

I.

Defendant admits the allegations of Paragraph I of the complaint.

II.

Answering the allegations of Paragraph II of the complaint defendant denies that the assessment and collection [66] of the taxes referred to in said Paragraph were erroneous or illegal.

III.

Defendant admits the allegations of Paragraph III of the complaint.

IV.

Defendant denies each and every allegation of Paragraph IV of the complaint.

V.

Defendant denies each and every allegation of Paragraph V of the complaint.

VI.

Answering the allegations of Paragraph VI of the complaint, defendant admits that no part of the taxes referred to in said Paragraph have been refunded to the plaintiff. Denies the remaining allegations of Paragraph VI.

Wherefore defendant prays that the complaint be dismissed, for its costs, and for such other relief as may be just.

(Receipt of Service)

FRANK J. HENNESSY
United States Attorney,
ESTHER B. PHILLIPS
Assistant United States
Attorney.

[Endorsed]: Filed Mar. 29, 1940. [67]

[Title of District Court and Cause.]

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DIRECTION FOR ENTRY OF JUDGMENT

The above entitled action came on regularly for trial before the above entitled Court, the Honorable Harold Louderback presiding, without a jury, on February 6, 1941, and the above named plaintiff and the above named defendant appeared by their respective counsel. Oral and documentary evidence on behalf of the respective parties was introduced and the cause was duly submitted to the Court for its decision and judgment, upon written briefs filed by the parties. The Court having fully considered the facts and the law applicable thereto and being fully advised in the [68] premises now makes its Findings of Fact and Conclusions of Law and directs entry of judgment, as follows:

Findings of Fact

1. Western Shore Lumber Company, the plaintiff herein, was organized under the laws of the

State of California in 1905 to acquire approximately 13,000 acres of timber land in San Mateo County and approximately 550 acres of timber land in Santa Cruz County, State of California. The Company was organized by Timothy Hopkins, then treasurer of the Southern Pacific Railroad Company, Senator Felton and certain associates who believed that the railroad was going to build a branch line through this area from San Francisco to Santa Cruz. However, the line was never constructed, and the Company has never engaged in active lumber operations.

2. During the early years of its existence, the Company permitted some timber and tanbark to be cut from its land in order to obtain funds for the payment of taxes and current expenses and in this way received a total of $36,449.56 during the period from its organization to and including the calendar year 1910. The Company likewise received from a similar source $25,094.63 during the period from 1911 to 1922 and in 1920 sold a portion of its acreage to the State of California for park purposes for a total purchase price of $38,400.00. The Company operated a small shingle mill for a brief period in 1918 and 1919 but the mill was shut down and was never operated after 1921. With this exception the Company has never engaged in any active operations of any kind.

3. Since the closing down of the shingle mill, the Company's activities have been confined to maintaining and holding its properties until such

time as the same could be satisfactorily liquidated. The Company paid Federal capital stock taxes in 1923, [69] 1924, 1925 and 1926 but subsequently filed claims for refund which were allowed in 1929, on the ground that the Company was not engaged in business during such years.

4. The yearly taxes upon the Company's properties have been quite substantial. For a time these taxes were paid out of funds on hand and loans made by stockholders. During the period from 1925 to 1929, the moneys necessary to pay taxes were raised by levying assessments upon the stockholders of the Company, but in 1929 in order to provide funds for this purpose and for current expenses, a stumpage contract was entered into with Santa Cruz Lumber Company by which that corporation was permitted to cut timber from an isolated portion of the Company's properties and was required to pay for the timber cut. Receipts from this source have been sufficient to pay the taxes and to reduce the indebtedness previously incurred to stockholders. The amount of such indebtedness on July 1, 1932 was $66,850.75.

5. The period in issue in this action is the period from July 1, 1932 to June 30, 1936. At the commencement of this period the assets of the Company consisted, as for many years previously, solely of approximately 12,500 acres of timber lands in San Mateo County and approximately 550 acres of timber lands in Santa Cruz County, State of California, and certain cash in bank accounts. During

the period from July 1, 1932 to June 30, 1936, the Company carried on no activities other than the holding and safeguarding of these timber properties and occasional negotiations looking toward their disposition as a whole. Very little supervision was necessary. The manner in which the Company conducted such activities as it engaged in was the same as in the period from 1922 to 1926. During this entire period there were no meetings of stockholders or of the Company and only three meetings of the board of directors, two of [70] which were in 1933 and one in 1936. The actions taken at the two meetings in 1933 were solely on routine corporate matters, such as the filling of vacant offices, authorizing the employment of auditors, et cetera, while the only non-routine business transacted at the meeting in 1936 was the ratification of a supplemental agreement with the Santa Cruz Lumber Company by which that corporation was permitted to cut timber under its existing contract on certain additional land of the Company.

6. With the exception of a supplemental agreement ratified at the meeting of the board of directors in 1936, the Company executed no contracts whatsoever during the period between July 1, 1932 and June 30, 1936. The Company purchased no property during this period, other than miscellaneous office supplies. It made no investments of any kind. It sold no property and carried on no business activities for profit. The only receipts of the Company during this period were interest on

its bank accounts and receipts under its stumpage contract with the Santa Cruz Lumber Company. The Company had no employes, except a secretary who was paid $25 per month and a caretaker employed to maintain the trails through the timber properties and keep a lookout for fires. The salary and allowances paid to the caretaker amounted to $1800 per annum. The only other disbursements made by the Company during this period were the payment of taxes, interest on its indebtedness, miscellaneous office expenses which were never in excess of $365 per annum, and the payment of $300 per annum as partial compensation to a man who checked the correctness of the timber talley made by the Santa Cruz Lumber Company under its timber stumpage contract with the Company. During this period, the Company made no distributions to shareholders except payments upon the interest and principal upon the indebtedness previously incurred by the Company for the [71] purpose of paying taxes.

7. The property of the Company is mostly redwood timber land and the Company at no time has considered timber operations upon this property but has been hopeful it would be able to sell the property as a whole to the State of California or to the County of San Mateo. Some negotiations have been had looking toward such a sale but have been unsuccessful. This property is the only large holding of redwood timber left in this territory and, for this reason, there have been some steps

looking toward its acquisition as a park property. The Company has been unwilling to sell the property piece meal but has carried on some negotiations looking toward its sale as a whole and has on several occasions given options to prospective purchasers although no such option was given during the period from July 1, 1932 to June 30, 1936.

8. The board of directors has given considerable thought as to a means of liquidating the property but has been unable to arrive at any program by which it could be liquidated except through a sale to the County of San Mateo or to the State of California or by a program of logging contracts which the Company does not care to undertake. Under these logging or timber stumpage contracts, the property made the subject thereof is completely deforested and rendered valueless. Approximately 1500 or 1600 acres have been subjected to logging or timber stumpage contracts with the Santa Cruz Lumber Company. These acres are in an isolated section of the properties of the Company and their deforestation does not affect the value of the remaining properties as a potential park site. The area which has been cut over is a steep side hill upon which nothing could be grown and, in the opinion of the [72] president of the Company, the land is probably worth only 50c an acre after deforestation.

9. The receipt of income under the timber stumpage contracts between the Company and the Santa Cruz Lumber Company constitutes the only

difference between the activities of the Company during the period from July 1, 1932 to June 30, 1936 and its activities during the period from 1922 to 1926 when the Company was not engaged in business for Federal capital stock tax purposes.

10. The timber stumpage contracts were entered into for the purpose of providing the Company with funds to pay taxes upon its property and current expenses. The first contract was executed on April 23, 1929 and related to 480 acres of land. Under this contract the Santa Cruz Lumber Company was given the right to remove from the described land all redwood and pine timber and tanbark for which it was to pay at the rate of $4 per thousand feet, board measure, in the case of redwood and pine and $5 per cord in the case of tanbark, with a minimum guaranteed payment of $10,000. The determination of the number of thousand feet, board measure, of timber cut was to be made by a talley at the tail end of the mill of the Santa Cruz Lumber Company, which talley was to be made by a talley man selected by the parties and whose expenses were to be borne equally. The Santa Cruz Lumber Company was required to proceed continuously with the removal of timber and tanbark from the lands described, and the Company had the right to inspect the operations of Santa Cruz Lumber Company and its books and records for the purpose of ascertaining that all of the provisions of the contract were complied with. This contract by its terms expired two years from its

date. A second contract was entered into between the same parties on March 10, 1930 and related to an additional 1360 acres of land and contained terms [73] similar to the contract of April 23, 1929. This contract was to run for a period of eight years provided that the Santa Cruz Lumber Company properly conducted the timber operations upon the properties of the Company. A third contract was entered into under date of January 17, 1936 between the same parties, relating to the same 480 acres covered by the contract of April 23, 1929, and provided that such acreage should be deemed to be covered by the contract of March 10, 1930.

11. The Company itself was required to take no action under any of these timber stumpage contracts, and its activities were in fact limited to the receipt of money, except that it paid the sum of $300 per annum to Mr. A. Stoodley, the talley man who was employed jointly on behalf of the Company and the Santa Cruz Lumber Company to verify the talley made by the Santa Cruz Lumber Company upon the basis of which payments for timber and tanbark were to be made. These payments were required to be made monthly and by virtue thereof, the Company received the following sums:

Year ending June 30	Amount received
1933	$21,206.70
1934	32,372.78
1935	4,625.93
1936	9,404.54

The portion of these receipts remaining after payment of taxes, current expenses and interest and after setting aside a reserve for future taxes, was used to retire in part the Company's indebtedness to stockholders. During this period this indebtedness was thus reduced by $13,821.89 and subsequently was entirely paid off out of timber stumpage receipts.

12. As a result of the receipts under the timber stumpage contracts, the Company had a profit, for income tax purposes, for the period from January 1, 1932 to December 31, 1936 [74] aggregating a total of $10,007.86, but its total deficit at December 31, 1936 was $165,846.69.

13. The timber stumpage contracts did not contemplate that the Company itself would engage in any operations, and the Company did not in fact do so. The contracts were in substance simply a license to an operating timber company to cut timber from an isolated section of the Company's properties under an agreement to pay for the timber so cut. The land from which the timber was cut was rendered substantially valueless and the operation amounted in essence to a liquidation of the property from which the timber was cut.

14. With the exception of the supplemental agreement dated January 17, 1936 which related to the same property covered by the earlier agreement of April 23, 1929, the stumpage agreements were not negotiated during the period involved in this action and the Company's only activity in re-

lation to said contracts was the receipt of the moneys payable thereunder and the payment of its share of the expenses of the talley man.

15. The dates of the filing by the Company of its returns under the capital stock tax law and of the payment of the tax thereunder and the amount of the tax so paid are as follows:

Year ending June 30	Date Return Filed and Tax Paid	Amount of Tax Paid
1933	August 29, 1933	$1250
1934	August 31, 1934	$25
1935	July 30, 1935	$24
1936	September 18, 1936	$1000

16. The Company filed claims for refund for the capital stock taxes paid for the taxable periods ended June 30, 1933, 1934, 1935 and 1936, together with interest, on August 28, 1937, on the ground that the Company had not carried on or done business [75] during any of the taxable years in question and that, accordingly, it was not subject to the capital stock tax.

17. By registered letter dated and mailed January 26, 1938, the Commissioner of Internal Revenue notified the Company of the rejection of its claims for refund of the 1933, 1934, 1935 and 1936 capital stock taxes and interest.

18. This action was timely commenced by the Company on November 30, 1939 for recovery of the capital stock taxes paid for the taxable periods ended June 30, 1933, 1934, 1935 and 1936, together with interest. The action is based upon the same

grounds as those set forth in the claims for refund.

19. The Company has not received by way of cash or in the form of any credit the amount of capital stock taxes paid for the taxable periods ended June 30, 1933, 1934, 1935 and 1936, or any part thereof, and the Commissioner of Internal Revenue has at all times retained the amount of said taxes and all thereof.

Conclusions of Law

1. A corporation such as the plaintiff, which has reduced its activities to the ownership and holding of property, the distribution of its avails, and doing only such acts as are necessary to the maintenance of its corporate existence, and the private management of its purely internal affairs, is not carrying on or doing business within the meaning of Section 215(a) of the National Industrial Recovery Act, Section 701(a) of the Revenue Act of 1934, or Section 105(a) of the Revenue Act of 1935, commonly known as the "capital stock tax law".

2. The liability of the plaintiff for capital stock taxes must be decided by the purpose for which the corporate [76] organization was maintained, and, where, as in the present case, there was no intent during the taxable period in question or for many years prior to such period to carry on any active enterprise and the sole purpose of the corporation was to hold its timber lands and effect a sale of the whole thereof as soon as a fair price could be obtained, the proceeds to be distributed to stockhold-

ers, and there was no purpose or activity which constituted efforts or the use of capital in the pursuit of gain and profit, the plaintiff was not carrying on or doing business within the terms of said "capital stock tax law".

3. At no time during the period from July 1, 1932 to June 30, 1936 did the plaintiff carry on or do business in such manner as to subject it to the said capital stock tax. The capital stock taxes paid by the plaintiff in respect of the period from July 1, 1932 to June 30, 1936 were collected from it and retained erroneously and without authority of law and contrary to the laws of the United States relating to Internal Revenue. Plaintiff having taken all proper steps for the refund thereof is entitled to the repayment of the aggregate amount of such taxes, together with interest, as provided by law.

Direction for Entry of Judgment

The Clerk is hereby directed to enter judgment in the following form forthwith upon receipt by him of this direction:

"[Title of District Court and Cause.]

JUDGMENT

The above entitled action came on regularly for trial before the above entitled court, the Honorable Harold Louderback presiding, without a jury, on February 6, 1941, and the above named plaintiff and the above named defendant appeared by their

respective counsel. Oral and documentary evidence on behalf of the respective parties was introduced and the cause was duly submitted to the Court for decision and judgment upon written briefs [77] filed by the respective parties. The court has fully considered the matter and has made and filed its Findings of Fact, Conclusions of Law and Direction for Entry of Judgment.

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed that plaintiff have and recover of and from defendant the total sum of $2,299.00, with interest on the respective amounts making up the said total sum at the rate of 6% per annum from the respective dates of payment thereof as set forth in the complaint to the date hereof, in the amount of $909.52, and together with interest on said total sum at the rate of 6% per annum from the date hereof to such date as the Commissioner of Internal Revenue may determine in accordance with the provisions of subsection (b) of Section 177 as amended of the Judicial Code (U. S. C., Title 28, section 284 (b)), and for its costs of suit herein incurred in the sum of $10.00.

Dated this 13th day of August, 1941.

HAROLD LOUDERBACK,
Judge of the above entitled Court"

Dated this 13th day of August, 1941.

HAROLD LOUDERBACK,
Judge of the above entitled Court.

Approved as to form as provided in Rule 22.

....

United States Attorney.

....

Assistant United States Attorney. Attorneys for Defendant.

A. CRAWFORD GREENE,
HENRY D. COSTIGAN,
ROBERT MINGE BROWN,
McCUTCHEN, OLNEY, MANNON & GREENE,
Attorneys for Plaintiff. [78]

Service and receipt of a copy of the foregoing Findings of Fact, Conclusions of Law and Direction for Entry of Judgment are hereby admitted this 5th day of August, 1941.

FRANK J. HENNESSY,
United States Attorney.
By ESTHER B. PHILLIPS,
Assistant United States Attorney. Attorneys for Defendant.

Filed Aug. 13, 1941. [79]

In the District Court of the United States in and for the Northern District of California, Southern Division.

No. 21438-L

WESTERN SHORE LUMBER COMPANY, a corporation,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

The above entitled action came on regularly for trial before the above entitled court, the Honorable Harold Louderback presiding, without a jury, on February 6, 1941, and the above named plaintiff and the above named defendant appeared by their respective counsels. Oral and documentary evidence on behalf of the respective parties was introduced and the cause was duly submitted to the Court for decision and judgment upon written briefs filed by the respective parties. The Court has fully considered the matter and has made and filed its Findings of Fact, Conclusions of Law and Direction for Entry of Judgment.

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed that plaintiff have and recover of and from defendant the total [80] sum of $2,299.00, with interest on the respective amounts making up the said total sum at the rate of 6% per annum from the respective dates of payment thereof as set

forth in the complaint to the date hereof, in the amount of $909.52, together with interest on said total sum at the rate of 6% per annum from the date hereof to such date as the Commissioner of Internal Revenue may determine in accordance with the provisions of subsection (b) of Section 177 as amended of the Judicial Code (U. S. C., Title 28, section 284 (b)), and for its costs of suit herein incurred in the sum of $10.00.

Dated this 13th day of August, 1941.

HAROLD LOUDERBACK,
Judge of the above entitled Court.

[Endorsed]: Filed Aug. 13, 1941. [81]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Now comes the defendant, The United States of America, appearing by Frank J. Hennessy, United States Attorney for the Northern District of California, and hereby appeals from the judgment entered against it in the above-entitled case on or about August 13, 1941.

Dated: Nov. 12, 1941.

FRANK J. HENNESSY,
United States Attorney.

ESTHER B. PHILLIPS,
Assistant United States Attorney.

[Endorsed]: Filed Nov. 12, 1941. [82]

[Title of District Court and Cause.]

DESIGNATION OF RECORD ON APPEAL

The defendant above named, having taken an appeal from the judgment entered herein by the United States District Court to the United States Circuit Court of Appeals for the Ninth Circuit, hereby designates the entire record and proceedings for inclusion in the record on appeal.

FRANK J. HENNESSY,
United States Attorney.

[Endorsed]: Filed Aug. 29, 1942. [82A]

[Title of District Court and Cause.]

ORDER FOR TRANSMITTAL OF EXHIBITS TO THE CLERK OF UNITED STATES CIRCUIT COURT OF APPEALS

Upon motion of the United States of America, appearing by Frank J. Hennessy, United States Attorney for the Northern District of California, the Clerk of the District Court is hereby ordered to transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, all exhibits introduced in evidence upon the trial of the above entitled case, for use in the prosecution of the appeal taken to the United States Circuit Court of Appeals for the Ninth Circuit.

A. F. ST. SURE,
United States District Judge.

[Endorsed]: Filed Aug. 25, 1942. [82B]

[Title of District Court and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including January 21, 1942, within which to docket its record on appeal in the above-entitled case.

Dated: Dec. 2, 1941.

A. F. ST. SURE,
United States District Judge.

[Endorsed]: Filed Dec. 2, 1941. [83]

[Title of District Court and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including March 2, 1942, within which to docket its record on appeal in the above-entitled case.

Dated: January 21, 1942.

CURTIS D. WILBUR,
United States Circuit Judge.

[Endorsed]: Filed Jan. 21, 1942. [84]

[Title of Circuit Court of Appeals and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including April 2, 1942 within which to docket its record on appeal in the above entitled cause.

Dated: March 3, 1942.

FRANCIS A. GARRECHT,
United States Circuit Judge.

[Endorsed]: Filed Mar. 3, 1942. [85]

[Title of Circuit Court of Appeals and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including May 2, 1942 within which to docket its record on appeal in the above entitled cause.

Dated: April 2, 1942.

FRANCIS A. GARRECHT,
United States Circuit Judge

[Endorsed]: Filed Apr. 2, 1942. [86]

[Title of District Court and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including June 2, 1942, within which to docket its record on appeal in the above-entitled cause.

Dated: April 28, 1942.

CURTIS D. WILBUR,
United States Circuit Judge.

[Endorsed]: Filed Apr. 29, 1942. [87]

[Title of Circuit Court of Appeals and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including July 2, 1942, within which to docket its record on appeal in the above-entitled case.

Dated: May, 1942.

CURTIS D. WILBUR,
United States Circuit Judge.

[Endorsed]: Filed June 2, 1942. [88]

[Title of Circuit Court of Appeals and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including August 3, 1942 within which to docket its record on appeal in the above-entitled case.

Dated: July 3, 1942.

FRANCIS A. GARRECHT,
United States Circuit Judge.

[Endorsed]: Filed Jul. 18, 1942. [89]

[Title of Circuit Court of Appeals and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including August 26, 1942 within which to docket its record on appeal in the above-entitled case.

Dated: August 13, 1942.

FRANCIS A. GARRECHT,
United States Circuit Judge.

[Endorsed]: Filed Aug. 13, 1942. [90]

[Title of Circuit Court of Appeals and Cause.]

ORDER EXTENDING TIME WITHIN WHICH TO DOCKET THE RECORD ON APPEAL

It Is Hereby Ordered that the defendant herein may have to and including September 10, 1942 within which to docket its record on appeal in the above-entitled case.

Dated: August 26, 1942.

WILLIAM DENMAN,
United States Circuit Judge.

[Endorsed]: Filed Aug. 26, 1942. [91]

CERTIFICATE OF CLERK TO TRANSCRIPT OF RECORD ON APPEAL

District Court of the United States
Northern District of California

I, Walter B. Maling, Clerk of the District Court of the United States, for the Northern District of California, do hereby certify that the foregoing 91 pages, numbered from 1 to 91, inclusive, which together with 1 Volume of the Reporter's Transcript, contain a full, true, and correct transcript of the records and proceedings in the case of Western Shore Lumber Company, a Corp., Plaintiff, vs. United States of America, Defendant, No. 21438-L, as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of ten-dollars and ten-cents ($10.10) and that the said amount has been paid to me by the Attorney for the appellant herein.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at San Francisco, California, this 10th day of September, A. D. 1942.

[Seal] WALTER B. MALING,
Clerk.

WM. J. CROSBY,
Deputy Clerk.

[Title of District Court and Cause.]

TESTIMONY

Thursday, February 6, 1941

Before: Hon. Harold Louderback,
Judge.

COUNSEL APPEARING:

For Plaintiff:

Messrs. McCutchen, Olney, Mannon & Greene,
By Robert Minge Brown, Esq.,
Owen Jameson, Esq.

For Defendant:

Miss Esther B. Phillips,
Assistant U. S. Atty.

Mr. Brown: If your Honor please, this is a suit by Western Shore Lumber Company, a California corporation, to recover approximately $2300 of capital stock tax paid for the years between July 1, 1932 and June 30, 1936, inclusive.

These taxes were paid under the provisions of the applicable sections of the Internal Revenue Statutes, which were Section 215A of the National Industrial Recovery Act of 1923, Section 701A of the Revenue Act of 1934, and Section 105A of the Revenue Act of 1935. The provisions of each of those Acts are similar as to the imposition of a tax upon corporations relative to the carrying on of business. The tax was increased in the last Revenue Act from $1 per thousand to $1.40, but the other provisions are similar. It is the position of the plaintiff that it was [1*] not at any time during these years carrying on or doing business, it was a lumber company holding its assets for liquidation. Its assets consisted of some timber lands in Santa Cruz and San Mateo Counties. It made no investments during that period. It bought and sold no assets during the period, except some timber sold under timber cutting contracts; it carried on no business of any kind. We have two witnesses, one the President of the Company, who has been connected with the company during all of the years material in question, and for many years prior thereto, and the secretary of the company, who has taken over those

*Page numbering appearing at top of page of original Reporter's Transcript.

duties recently, but his predecessor is not available. I do not know whether Miss Phillips wishes to make a statement.

Miss Phillips: Just briefly. Counsel has stated the issues. It is a suit for refund of a capital stock tax for four years, and the issue is whether the plaintiff company was doing or carrying on business during the years in question.

Originally, the plaintiff filed its capital stock tax return and paid the tax, and subsequently filed a claim for refund on the theory that it was not doing business. The jurisdictional requirements have been met, that is, the claim for refund has been filed for the years in question. The issue in the case is exactly the same as presented in the claim for refund. There are no jurisdictional defects in the case.

The Court: The question is as to whether they were doing business during those years?

Miss Phillips: As defined under the statute, whether they were carrying on and doing business and remained within the purview of the Capital Stock Tax Statute.

Mr. Brown: I will call Mr. Wood. [2]

PERCY A. WOOD,

Called for the Plaintiff; Sworn.

Mr. Brown: Q. What is your name?

A. Percy A. Wood.

(Testimony of Percy A. Wood.)

Q. By whom are you now employed?

A. By the Wells Fargo Bank & Union Trust Company.

Q. How long have you been in the employ of that bank, approximately? A. Since 1917.

Q. Are you an officer of the Western Shore Lumber Company, the plaintiff in this case?

A. I am the President of the Western Shore Lumber Company.

Q. When were you elected president of the company? A. I think in February, 1936.

Q. Who was your predecessor in office?

A. Timothy Hopkins.

Q. Is Mr. Hopkins now living?

A. Timothy Hopkins died January 1, 1936.

Q. Are you a director of the company?

A. Yes.

Q. When were you elected a director?

A. I think in February of 1925.

Q. Have you been continuously a director since that time? A. I have.

Q. How long had Mr. Hopkins served as President of the Company?

A. I cannot answer that definitely, but for many, many years prior to the time that I became connected with the company, and all the time during the time I was a director up to the time of his death.

Q. What occasion did you have to consult with Mr. Hopkins regarding the affairs of the Western Shore Lumber Company?

(Testimony of Percy A. Wood.)

A. I became a director of the Felton Company in 1925, and the Felton Company was a stockholder of the Western Shore Lumber Company; they also had certain stock in the Western Shore Lumber Company, and [3] from that time I became associated on behalf of the Felton Company with the Western Shore Lumber Company.

Q. What was your connection with the Felton Company?

A. I was a director at that time.

Q. On whose behalf were you elected a director?

A. I was elected a director to fill the place of Timothy Hopkins, who had resigned as a director of the Felton Company.

Q. In the course of your employment by the bank did you have any occasion to watch the progress of the Western Shore Lumber Company?

A. Yes. As a matter of fact, I conferred, when there was any reason to confer, with Mr. Hopkins, or he conferred with me relative to the Western Shore Lumber Company and its property.

Q. Were there any trusts in the bank which held stock in the Western Shore Lumber Company?

A. Yes, two.

Q. Which trusts are those?

A. There is the Timothy Hopkins Trust, and another trust, and then there is the trust of Mrs. Kate Felton Elkins, which owns a majority of the stock in the Felton Company.

(Testimony of Percy A. Wood.)

Q. When was the Hopkins trust established?

A. March, 1934.

Q. How many shares of stock in the Western Shore Lumber Company did the Hopkins trust own? A. 4551 shares.

Q. When was the Elkins trust established?

A. In January, I think, of 1925.

Q. How many shares did it own?

A. The Felton Company held 1914 shares which it owned outright, and had 1275 shares which it held as pledgee.

Q. What connection do you have with the administration of those trusts?

A. They are directly under my supervision.

Q. What kind of supervision did Mr. Hopkins exercise over the [4] affairs of the company prior to his death?

A. Well, as a matter of fact, there was not a great deal of supervision necessary. The company owned a little over thirteen thousand acres of timber land in San Mateo and Santa Cruz Counties, which it had owned for many, many years. As a matter of fact, there was hope of selling the property as a whole; we had no intention of selling it by part and parcel, and would like to liquidate the entire company, so there was very little supervision in connection with it.

Q. How frequently would you say that you communicated with Mr. Hopkins regarding the affairs of the company?

(Testimony of Percy A. Wood.)

A. I would say not more than probably twice a year.

Q. What were the activities of the company when you became a director?

A. Well, the activities of the company were merely holding the title to the timberland. The company had no activities.

Q. Was the timberland the sole assets of the company?

A. The timberland, on which there were a few shacks, I think on what is known as Section 11, and they had a bank account.

Q. Do you have any idea how much was deposited in the bank account?

A. I have not the least idea at the present time.

Q. What kind of timber was on the land owned by the company?

A. Mostly redwood, and what is now termed fir—the predominant timber was redwood.

Q. What was the company source of income prior to 1932?

A. As I remember, the company practically had no income; it was very, very small, as a matter of fact.

Q. How did the company pay taxes on its property during that period?

A. It levied assessments on its stockholders.

Q. Did the company have any indebtedness prior to 1932?

A. It had an indebtedness to its stockholders

(Testimony of Percy A. Wood.)

for money which was [5] advanced by the stockholders with which to pay the taxes.

Q. Has that indebtedness been paid off?

A. It is now all paid, yes.

Q. Do you have any idea what that indebtedness amounted to as of say, July 1, 1932?

Miss. Phillips: Do not the books show the exact details on this?

Mr. Brown: Yes, they will. I merely wanted to show for what purpose this indebtedness was incurred, and whether or not it was a specific amount.

A. I could not answer what the indebtedness was in 1932. When Mr. Hopkins died, on January 1, 1936, it was $44,000, and since 1936 it has all been paid off.

Q. When you became a director of the company was it engaged in any lumber operations?

A. No.

Q. During the time you have been a director has there been any discussion of timber operations on behalf of the company?

A. No, it has never been the intent or purpose of the company to carry on lumber operations in any way.

Q. During the period prior to 1932 were there any negotiations looking toward the sale of the property?

A. Yes, there were negotiations with a firm I believe from Indianapolis, the name of which I have forgotten at the moment, and in fact the sale was

(Testimony of Percy A. Wood.)
almost consummated, the contract was almost completed, when a flood went through the part of the country where the firm operated in the Middle West, and wiped the company out, and that was the end of the negotiations.

Q. Has the company been willing to sell this property piecemeal? A. No.

Q. Why has the company been unwilling to sell it piecemeal? [6]

A. Because it is a very large body of timber, 13,000 acres, between Pescadero and Butano, just to the north of the California Big Basin. Mr. Hopkins and the directors have thought many years, they hoped it would be a part of the Big Basin Park, and it was the hope of the directors and also some of the residuary beneficiaries under the trust, like Stanford University, that the property could be sold to the State of California, or to San Mateo County.

Q. Did the company sell any of its real estate during the period from July 1, 1932 to June 30, 1936? A. No.

Q. What did you sell during that period?

A. Well, we sold some timber, as a mater of fact, on certain isolated sections, which were not connected with the main body of the property.

Q. How was that property sold?

A. It was sold under a regular timber contract to the Santa Cruz Lumber Company.

(Testimony of Percy A. Wood.)

Q. You say a regular lumber contract, what do you mean?

A. I mean there was a contract made with the Santa Cruz Lumber Company, permitting them to cut timber at so much per thousand.

The Court: Q. In other words, you designated an area in which they had the right to cut timber, and they paid you so much a thousand feet for what they actually cut down and took away?

A. That is correct.

Mr. Brown: Q. Mr. Wood, I show you a contract dated March 10, 1930, between the Western Shore Lumber Company and the Santa Cruz Lumber Company, and a supplemental agreement dated January 17, 1936, between the same companies. Are those the contracts to which you refer?

A. They are.

Mr. Brown: I would like to introduce these contracts in evidence.

The Court: Are there two contracts? [7]

Mr. Brown: Yes, one is the original contract and the other is a supplemental contract.

The Court: The original contract will be marked "Plaintiff's Exhibit 1," and the supplemental contract will be marked "Plaintiff's Exhibit 2."

Mr. Brown: We would like to withdraw the originals upon substitution of photostats of the originals.

The Court: There is no objection on the part of defendant?

(Testimony of Percy A. Wood.)

Miss Phillips: No objection.

The Court: That may be done.

(The documents were marked, respectively, Plaintiff's Exhibits 1 and 2.)

[Plaintiff's Exhibits Nos. 1 and 2 are set out at pages 188 and 204 respectively of this printed record.]

Mr. Brown: Q. Has the company made any investments during that period from July 1, 1932 to June 30, 1936?

A. Well, not what I would call investments. We bought supplies for letters that had to be written.

Q. You have not invested any money with a view of earning income from it? A. No.

Q. What did you do with the money received from these timber contracts?

A. The receipts from the timber contracts were largely used to pay taxes.

Q. Was there any balance left over after the payment of taxes?

A. Yes, that balance was carried over; rather than levy assessments to pay taxes on the stockholders, we carried the balance over to pay taxes.

Q. Has there been any distribution to shareholders from the proceeds of these timber contracts?

A. I would not say from the proceeds of these timber contracts, no.

Q. What provision was made under these timber contracts for verifying the sums payable to the company?

(Testimony of Percy A. Wood.)

A. Well, we employed [8] a Mr. A. Stoodely, of Santa Cruz, who was a very competent timber man, as a matter of fact, to check the operations of the Santa Cruz Lumber Company, to see that we got the right amount that was coming to us.

Q. Do you know what kind of a check he made on the cutting operations?

A. Yes, Mr. Stoodely first checked their inventory before they started cutting, and then he made out what we would call a tally, as the lumber went through, and they would check the inventory against it, and that is the way the checks were made.

Q. What was Mr. Stoodley's salary?

A. Mr. Stoodley received $25 a month.

Q. Did the company exercise any other supervision over the timber cutting operations?

A. None at all.

Q. Was there any connection between the Western Shore Lumber Company and the Santa Cruz Lumber Company?

A. Except as to the matter of the contract for the cutting of timber, that is all. There is no stock ownership or anything of that kind.

Q. How has that company safeguarded the property during the period to June 30, 1936?

A. For some years, as a matter of fact, we had a man there named Mr. Bennett, who was an elderly gentleman, who lived on Section 11; he was simply a caretaker, who tried to look out for fires, for the reason at that time the fire patrol was not put

(Testimony of Percy A. Wood.)
in the necessary outlying places, so fires were readily discovered, so Mr. Bennett was simply looking out for fires and seeing that the trails were kept up.

Q. Was he employed when you became a director of the company? A. Yes.

Q. When did he resign?

A. I think he resigned in 1937.

Q. He was employed all the period from July 1, 1932 to June 30, [9] 1936? A. Yes.

Q. What was his compensation?

A. He received $125 a month as salary and $25 a month as an allowance for his horse.

Q. Did the company have any other employes during the period from July 1, 1932 to June 30, 1936?

A. Well, we had Mr. Stoodely to check the timber, and tally it, and Mr. Bennett, who was the watchman down there, and of course the Secretary of the company here in San Francisco.

Q. What were the duties of the Secretary?

A. The duties of the Secretary are merely to keep the books and attend the meetings of the board of directors, and write up the minutes.

Q. What was the compensation of the Secretary, approximately?

A. I think the compensation of the Secretary was $25 a month.

Q. Was Mr. Hopkins paid any compensation?

A. No.

Q. Has the dissolution of the Western Shore

(Testimony of Percy A. Wood.)

Lumber Company ever been discussed at any of the meetings of the Board of Directors which you attended?

A. No, we had never discussed the question of dissolution, but we have discussed many times the question of what progress we could make toward liquidation of the company.

Q. Has it been the practice of the company to refer all matters of importance to the board of directors? A. Yes.

Q. Have you attended all meetings of the board of directors?

A. To the best of my recollection I have attended all meetings; in fact, our meetings are very infrequent.

Q. Are you familiar with the minutes of the meetings of the board of directors? A. Yes.

Mr. Brown: I am asking him the question about the minutes, because there is no one else that knows about them. We will introduce the books by the Secretary of the company, but he was not [10] secretary at that time.

Q. In your opinion do the minutes recorded in the book of minutes reflect all actions taken by the board of directors? A. Yes.

Q. Were there any meetings of stockholders during the period from July 1, 1932 to June 30, 1936?

A. I think there were one or two meetings of stockholders,—I could not say definitely—simply for election of directors and officers.

(Testimony of Percy A. Wood.)

Q. Apart from the receipt of income under the contracts you have previously mentioned, did the company have any source of income during the period from July 1, 1932 to June 30, 1936?

A. Not in the sense of income—no other income from any other source except possibly it might have sold a few steel cables for junk—that was out on Section 11—it was a very small item. As a matter of fact, it only amounted to a few hundred dollars.

Q. You mentioned the company had some cash on deposit. Did it receive any interest on that cash?

A. A portion of that was deposited in a savings account, on which it received interest.

Q. Did you invest any of those funds in any securities or bonds? A. No.

The Court: Did that income of the company go on during the entire four years? A. Yes.

Q. During all of that period it was going on?

A. Yes, that is right.

Mr. Brown: I believe that is all.

Cross Examination

Miss Phillips: Q. Mr. Wood, the Western Shore Lumber Company was organized about the close of 1905, was it not?

A. I think that is correct.

Q. And during that time, or at the start of its career it [11] acquired timber lands both in Santa Cruz and San Mateo Counties? A. Yes.

(Testimony of Percy A. Wood.)

Q. The acreage was approximately 13,000 in San Mateo County, and 550 in Santa Cruz County?

A. That is approximately correct.

Q. And approximately 480 acres were sold of the Santa Cruz acreage in 1920, isn't that right?

A. I don't remember.

Q. Would it be possible to ascertain that? I would like to have the exact acreage of the company at the start and then whatever sales have been made, so as to know exactly what its acreage was.

A. You mean the acreage as of today?

Q. Yes.

A. I can give you fairly accurately, I think—I won't say that this is absolutely accurate to the acre, but it is approximately 13,239 acres.

Q. Won't you look up your records for 1920 and ascertain if this is not true, the company sold 480 acres for $38,400, at the rate of $80 per acre?

A. The records that I have would not show that. I would have to look at the records of the company.

Q. The books of the company would show that?

A. Mr. Nelson, the Secretary, has the books of the company. Nothing has been sold that I know of since I became a director in 1925.

Q. I am asking you as to the fact; surely you can find that out?

A. The books will show that.

Q. Do you know under what circumstances the company acquired this land in 1905?

A. Well, I can give you what I understood to be the theory of their acquiring it.

(Testimony of Percy A. Wood.)

Q. I would like to have more definite information that what you understand or think. How did this company acquire, at the start of its career in 1905, over 13,000 acres of timber land? Was it a gift?

A. No. I can tell you the historical background of it, I mean to the best of my knowledge as I have it. [12]

Q. Do your books show? Was it a purchase?

A. Yes, the property was actually purchased.

Q. It was actually purchased? A. Yes.

Q. The articles of incorporation which are attached to the complaint show who were the stockholders and how they started the actual purchase of this land?

A. The actual purchase of the property.

Q. Did they ever build a mill?

A. Oh, sometime prior to—I don't know when, but they did build a shingle mill on what is known as Section 11; they operated, as I understand it, about thirty days, and it was then discontinued.

Q. That was in 1920, was it not?

A. No, that must have been prior to 1920.

Miss Phillips: I am afraid the witness does not know enough about it. Is there anybody here that can give exact answers? I mean there is no use wasting time with this witness on that.

Mr. Brown: The period prior to 1920, I am not sure whether it is material to the question of whether they were doing business in 1932.

(Testimony of Percy A. Wood.)

Miss Phillips: Oh, yes.

Mr. Brown: This company was run by its President, Mr. Hopkins, without compensation, and he is dead. I believe the witness has testified that he had almost complete supervision of the company. The Secretary is also dead. Mr. Wood became a director in 1925.

Miss Phillips: That is all right, but the company has records.

Mr. Brown: We will be glad to get the records for whatever period you suggest.

Miss Phillips: The question whether a company is doing business during any one year does not depend exactly on evidence [13] of its activities during that year. It is possible to go back into the history of the company for many years.

Mr. Brown: That is correct.

Miss Phillips: After all, it is a question of relevancy and pertinency, and the question of whether a particular company is doing business is a question of fact, of what it was organized for and how it was carried on during all of its preliminary career.

Mr. Brown: I think it is also relevant to point out that there was a capital stock tax during the years 1922, 1923, 1924 and 1925, and this company paid the capital stock tax for those years and filed a claim for refund for those years, and that was granted, and the Commissioner paid the plaintiff.

Miss Phillips: This witness has just testified

(Testimony of Percy A. Wood.)

on direct examination for a period of years they cut no timber, made no sales. He has testified that in the years 1932 to 1936 they were cutting timber and selling it right along during those years. He has said in 1925 they were not cutting timber. Of course, if they were not cutting or selling that is a different thing.

Q. Mr. Wood, do not the books of the company show that during the entire history of this company it has been selling redwood and pine timber?

A. I do not think so. There is an historical background as I know it, I won't say as I know it, but as I understand it.

Miss Phillips: Let us not have hearsay on this. I am not saying the books of the company ought to be excluded because the people who kept them are dead. Of course, I have no doubt those books of the company were accurately kept.

Mr. Brown: We would be glad to introduce them. I do not think 1920 is material to what happened in 1932. [14]

Miss Phillips: Q. The company maintains a depletion schedule, does it not? A. Yes.

Q. And charges in the income tax return year to year the amount of redwood and timber taken off the land, which to that extent is a depletion of capital? A. That is right.

Q. I want to ask you if it is not a fact that during the years 1909 and 1910, during that period, the Western Shore Lumber Company was not selling its redwood timber?

(Testimony of Percy A. Wood.)

A. In 1909 and 1910?

Q. Yes. A. I don't know.

Q. Would you say, Mr. Wood, the redwood and pine was of a good quality?

A. When you mention quality, I would say it is, compared with what you would call Northern redwood, not of first class quality. The timber, as I understand it, in Santa Cruz and San Mateo County is sparser and not as thickly grown as it is in Eureka, and Humboldt County.

Q. Is it easy of accessibility?

A. Not particularly.

Q. Not particularly? A. No.

Q. Isn't it true that it sold annually redwood timber from these lands?

A. Not annually. The only sales it made are the ones represented by these contracts with the Santa Cruz Lumber Company.

Q. A stumpage contract—the sale of standing timber, the person buying it to take it out, is that correct? A. Yes.

Q. A stumpage contract is a sale of standing timber? A. Yes.

Q. The timber was actually sold and the proceeds credited to your company's operations during that year?

A. The timber, of course, was standing timber, which was sold to the Santa Cruz Lumber Company, and the Santa Cruz Lumber Company, as a lumber company, in its operations cut the timber

(Testimony of Percy A. Wood.)

and manufactured it into lumber. The Western Shore Lumber Company had nothing to do [15] with the cutting of it, or the manufacture of it. All it had to do was to check up the amount that it was entitled to on a stumpage basis.

Q. Would you be able to say what portion of the history of the company since 1905 it has carried its affairs in the same way as it did from 1932 to 1936?

A. I could only tell you what I have been told historically. I can tell you from 1925, when I became a director, what happened; I mean from 1925 on the company has done nothing except in connection with these contracts.

Q. The first contract offered in evidence is dated in 1930, and the supplemental contract is 1936. Now, am I to understand that from 1925 to 1930 there were other contracts of the same sort?

A. I think there may have possibly been a contract in 1929. I may be mistaken as to the date 1929, or 1930, but from 1925 up to that time there were no other contracts.

Q. But were there any contracts at all?

A. No.

Q. That is, from 1925 to 1930 there were no stumpage contracts? A. No.

Q. Is that right?

A. That is correct.

Q. You did not make any sales of timber during that period? A. No.

Q. In 1930 you began selling timber?

(Testimony of Percy A. Wood.)

A. On the isolated property.

Q. Which tract was that?

A. I could give you a description from the map.

Q. Is it described in the contract?

A. It is described in the contract.

Q. Then during the years 1920 to 1925 you are not able to say whether there were any contracts or not?

A. There were not in 1925 up to 1930.

Q. Now, as to 1920 to 1925, do you know whether there were any contracts then?

A. I do not know. [16]

Q. Then take the period between, let us say, 1905 and 1913, that period in there, would you know anything about that? A. No.

Mr. Brown: Your Honor, I object to these questions. I have not understood your Honor to rule whether 1912 or 1913, or 1910, or 1929, or 1920 relevant to this matter. The regulations recognize that a corporation may have been doing business in the past and nevertheless not be doing business now.

Miss Phillips: That is quite true. Counsel and I will not have any argument about that. My position is this, here is a company that has been running thirty-five years, and if we are to take what the witness says on the stand as a fact, in all of the time of its history never has it done business. The land was bought 35 years ago, and he testified it was purchased. It was not a gift. I think I can

(Testimony of Percy A. Wood.)

show that it has been logged for redwood year after year. The witness has just stated that there was no contract, they were holding it, obviously during that time they were not doing business.

Mr. Brown: You said they were not doing business?

Miss Phillips: During the period from 1905 on there have been periods in which it has been selling timber, at a profit. Under what circumstances can we say he is not doing business?

The Court: I can see where it may be relevant to trace it right through.

Miss Phillips: That is what I am trying to do.

The Court: I think it is competent to show what this corporation has been doing and is likely to have as a consequence of that.

Miss Phillips: Q. You have mentioned the fact that there were assessments to pay taxes and running expenses. Do you know how many assessments have been levied in the history of the company? [17]

A. In the history of the company?

Q. Yes. A. No.

Q. I would like to ask you if you won't examine the books of the company and see if it is not true that it had assessments during the years 1925 and 1929 of 50 cents per share, during the year 1927 assessments of 50 cents per share, during the year 1926 65 cents per share, and during the year 1928 60 cents per share, and if it is not

(Testimony of Percy A. Wood.)

a fact that those are the only assessments levied against the stockholders during the entire history of the company. I would like to ask if that can be checked to ascertain whether that is the fact.

A. So far as I know those are correct as to the assessments levied between 1925 and up to the date of the last one. As to the assessments levied prior to 1925 I have not any knowledge, at all.

Q. Then the question would be whether or not there had been any other assessments other than those I named?

A. There have been no assessments from the date of the last one you mentioned up to the present time, but from 1925 back I do not know.

Q. My question is whether or not it cannot be ascertained whether there were any assessments between the year 1905, when it started, and 1925, when the first assessment was made?

A. I think the books will show that.

Q. Has there ever been a resolution of the stockholders directing a liquidation of the company? A. No.

Q. Has there been any resolution by the board of directors for liquidation? A. No.

Q. It is true, is it not, that at one time in its history the stockholders made loans to the company in proportion to their ownership?

A. That is correct.

Q. Can you state at this time when those loans were made? [18]

(Testimony of Percy A. Wood.)

A. I think the loans were made prior to 1925.

Q. And they were made in proportion to their stock ownership?

A. In proportion to their stock ownership.

Q. Your books of account will show interest payments to stockholders during that period?

A. That is correct.

Q. And those would be the interest payments made to stockholders upon the loans they made?

A. I think the books will show there was quite some period, as a matter of fact, that there was no interest paid on the amount advanced by stockholders, but the amount of interest computed on those advances, and those were simply added to the advances to increase the principle of them.

Q. Was it your testimony on direct examination that those loans have all been paid off?

A. They have all been paid off since 1938.

Q. You have testified on direct examination that there were from time to time some years in which there was a surplus which was carried over into the balance sheet of the company?

A. I would not say a surplus. Let me put it this way: Under these contracts with the Santa Cruz Lumber Company they made certain payments. Those funds were used, as a matter of fact, to pay taxes with. Naturally, there would be a balance carried over from one year to the other, which would be a surplus, a cash balance—there was a cash balance carried over because we do not know

(Testimony of Percy A. Wood.)

how long this thing would run or whether the property would be sold, or when it would be sold, so we would have cash on hand to pay taxes with, so we would not have to levy more assessments on stockholders.

Q. I accept your correction of cash balance; it is a much more correct term. The cash balance was carried over from year to year?

A. Yes. [19]

Q. You mentioned all of the stockholders have been paid back their loans. Were they paid off out of this accumulated cash balance?

A. They have been paid out of funds received from the Santa Cruz Lumber Company, on the contract made in 1938.

Q. Was that for a sale of more timber, or a sale of land?

A. The sale of more timber. That was in 1938.

Q. A stumpage contract, or a similar contract as the preceding ones? A. Very similar.

Q. So that we are to understand, then, that the loans of the stockholders have in fact been paid out of the accumulated cash balance of money received from the stumpage contract from the sale of timber?

A. I would distinguish between accumulated cash balance, because I think, if my recollection is right, that our cash balance was not very much at the time we made this contract with the Santa Cruz Lumber Company in 1928, and out of pay-

(Testimony of Percy A. Wood.)

ments received under that contract the indebtedness has been paid off.

Q. Have you ever retired any of your stock?

A. No.

Q. There are still outstanding how many shares of stock? A. 10,000 shares.

Q. At a par value of how much?

A. $100 a share.

Q. Or $1,000,000? A. Yes.

Q. Your books will show the extent of accumulated surplus? A. Yes.

Q. You mentioned the fact that there was a man who was paid as a tally man; your timber man was really representing your interest under the contract? A. That is correct.

Q. To make sure that whatever timber was cut you got credit for it, and you got the proper purchase price? A. Yes.

Miss Phillips: I think that is all. [20]

Re-direct Examination

Mr. Brown: Q. Mr. Wood, Miss Phillips asked you about any other timber contracts, and I believe you testified that there may have been a contract in 1929. I would like to show you an agreement dated April 23, 1929, between the Western Shore Lumber Company and the Santa Cruz Lumber Company, and ask you if that is the contract to which you referred.

A. That is correct.

Mr. Brown: Your Honor, this contract is at-

(Testimony of Percy A. Wood.)

tached as an exhibit to the complaint in this action, and I believe that it is satisfactory to Miss Phillips to stipulate that the copy so attached is a correct copy.

Miss Phillips: That will be all right, I have no objection to that.

Mr. Brown: Q. Apart from the three timber contracts which have been introduced in evidence, did the company execute any other contracts during the period you were a director up to and including June 30, 1936?

A. To the best of my recollection there was no other contract executed.

Q. Do you have any information of how many acres of land are covered by these timber contracts?

A. As a rough estimate, I would say approximately 1600 acres of timber, which, as I say, is isolated from the large body of timber, which is all of one body.

Q. Can you give a brief description of the physical characteristics of that land?

A. The physical characteristics—as a matter of fact the Santa Cruz Lumber Company has a plant, a mill on Section 27, in Township 8 South Range 3 West, which is, you might say, it is almost in a canyon. This section on which this timber was sold is rough, rises very abruptly. It is a side hill, very precipitous; that is were the timber was removed from by the Santa Cruz Lumber Company. [21]

Q. Is this body of timber separated from the remaining timber in any way?

(Testimony of Percy A. Wood.)

A. Oh, yes, completely isolated from the remaining body of our timber, what is known as the Pescadero and Butano timber.

Q. In your opinion did the sale of this timber impair the value of the remaining holdings?

A. Not in any way. As a matter of fact there was property between the section we owned that had been timbered off by the Santa Cruz Lumber Company, and our main body, that was owned by the Spring Valley Water Company, I believe.

Q. Have you made any effort to sell the main body of timber?

A. Well, not particularly, no, because as a matter of fact, as I say, we hope that the State of California will take a very large part of the property in connection with the California Redwood Basin, or it possibly may be that San Mateo County may take what is known as the Pescadero portion of the property.

Q. Have there been any negotiations?

A. With San Mateo County, yes.

Q. Have there been any negotiations with the State of California?

A. Mr. Drury, who is Secretary of the California Redwood Association, from time to time has been endeavoring to secure an appropriation by the State of California with which to buy this timber.

Q. For what period of time?

A. That has been going on for a considerable

(Testimony of Percy A. Wood.)

number of years, as far back as I can remember, 1925. As a matter of fact, the State now has made an appropriation to buy another tract of land there, which is not owned by the Western Shore Lumber Company, but was owned by Timothy Hopkins.

Q. Did those negotiations continue during the period you have been affiliated with the company?

A. That is correct.

Q. What is your understanding of the purpose for which the Western Shore Lumber Company is organized? [22]

Miss Phillips: I am going to ask, your Honor, that the witness testify of his own knowledge.

Mr. Brown: I am asking for his understanding.

The Court: What his understanding is is a conclusion, and not his knowledge.

Mr. Brown: I will reframe the question.

Q. What is your understanding, based upon discussions with the Board of Directors of the purpose for which the company is organized?

A. The company, if I remember correctly, was organized in 1905, by Timothy Hopkins, who was then treasurer of the Southern Pacific Railroad, and Senator Felton, and several other associates, and they thought that the Southern Pacific Railroad Company was going to build a railroad going south from San Francisco to Santa Cruz, and I assume they thought if the railroad did go through the property they would operate this property. In fact, the railroad was never built.

(Testimony of Percy A. Wood.)

Q. Was there any discussion of the railroad going through during the period you were a director? A. No, none at all.

Q. You have referred to some assessments levied on the stockholders. Do you know for what purpose those assessments were levied?

A. The assessments were levied for the purpose of paying taxes on the real estate.

Q. Do you know for what purpose the indebtedness to which you referred was incurred?

A. The money which was loaned by the stockholders was also loaned to the company for the purpose of paying taxes on the real estate.

Q. Has the company sold any of its acreage during the period you have been a director?

A. No.

Q. When you refer to timber sales, then you refer only to the timber contracts that have been introduced in evidence? [23]

A. That is correct.

Q. Have the activities of the company changed their character any during the period you have been a director? A. I would say no.

Q. What differences, if any, were there between the manner in which it transacted its business when you became a director and the manner in which it transacted it during the year from July 1, 1932 to June 30, 1936? A. No difference.

Mr. Brown: That is all.

(Testimony of Percy A. Wood.)

Recross Examination

Miss Phillips: Q. You don't know, yourself, when the loans of the stockholders were made, and how much? A. No.

Q. That would be a matter for the secretary?

A. That is correct.

Q. What section did you say the mill of the Santa Cruz Lumber Company was located on?

A. I think the mill is on Section 27, Township 8 South, Range 3 West.

Q. Then going back to your understanding as to why this company was organized, as I understand it, then, it was organized as a business venture, that is, the land was purchased with the idea of developing it in case the railroad went through: is that right? A. That is right.

Q. That represented an actual investment of capital? A. Yes.

Q. On which the investors hoped to get a business return? A. That is correct.

Miss Phillips: That is all.

FRANK C. NELSON,

Called for the Plaintiff; Sworn.

Mr. Burns: Q. What is your name?

A. Frank C. Nelson.

Q. By whom are you employed?

A. I am employed by Lester, Herrick & Herrick. [24]

(Testimony of Frank C. Nelson.)

Q. What is the nature of your business?

A. Certified Public Accountant.

Q. How long have you been a certified public accountant? A. Since 1925.

Q. What connection do you have with the Western Shore Lumber Company?

A. I am secretary of the company.

Q. When did you become secretary?

A. In March, 1937.

Q. What connection do you have with auditing the books of the Western Shore Lumber Company?

A. The firm to which I belong make an audit annually.

Q. When did you commence the making of such audits?

A. In March, 1937, when I was appointed secretary.

Q. When you became secretary were the books and records of the company turned over to your custody? A. They were.

Q. Do you have the original books and records which were received by you in your possession in court?

A. I have a number of them—not all of them in court, but I have a great number.

Q. Which records have you now?

A. I do not have the capital stock records with me, and there are of course a number of papers and cancelled checks and bank statements and documents of that sort, which I do not have with me.

(Testimony of Frank C. Nelson.)
I have a ledger which goes back to 1905; I have a cash ledger which goes back to 1933.

Q. Do you have the records of all of the receipts and disbursements during the period from July 1, 1932 to June 30, 1936? A. I do, yes.

Q. Can you tell us what the receipts in the year from July 1, 1932 to June 30, 1933, were?

A. Can I look at my records?

Q. Yes.

A. From July 1, 1932 to June 30, 1933 the receipts consisted of $21,206.70, from a stumpage contract of the Santa Cruz Lumber Company, and interest on the bank account of $451.44 [25] making a total of $21,658.14.

Q. What were the disbursements of the company during that year?

A. The disbursements during that period were taxes of $6024.75, which included property taxes of $5998.74. State Franchise Tax of $25, and Federal taxes on bank checks was $1.28; interest on the loan of stockholders was $4011.05, Trail Making Expense $1650, Secretary and Secretary's Expenses $550.70, and some miscellaneous expenses, including office rent, accounting service, etc., amounting to $364.60.

Q. Do your records show what was the amount of the indebtedness to stockholders as of July 1, 1932?

A. The indebtedness to stockholders on July 1, 1932 in the aggregate would be $66,850.75.

(Testimony of Frank C. Nelson.)

Q. Do the records indicate whether the interest paid during that year covered prior years?

A. I would have to check that, Mr. Brown, but I can do that in just a moment, I believe. The total interest paid during that period was $4,011.05, and that would be approximately 6 per cent., which was the rate of interest on $66,850.75, so I presume it was one year's interest.

Q. Do you have the records of the receipts and disbursements of the year from July 1, 1933 to June 30, 1934? A. Yes, I have.

Q. What were the receipts of the company during that period?

A. The receipts were $32,372.78, under the stumpage contract with the Santa Cruz Lumber Company, and interest on the savings account $841.56.

Q. What were the disbursements during that period?

A. The disbursements during that period were repayment of principal of outstanding stockholders' loans of $13,821.89, Interest on loans $5613.73, Taxes $5610.86, an item called "Train maintenance," including the salary and expense of Mr. Stoodely, I believe, was $1800, expense of secretary $275, and miscellaneous expenses including [26] office rent aggregated $364.94.

Q. What were the receipts during the year from July 1, 1934 to June 30, 1935?

A. The receipts were $4625.93 under the Santa

(Testimony of Frank C. Nelson.)
Cruz Lumber Company contract, $562.05 interest on savings account, and $50 received from salvage of equipment on an old shingle mill.

Q. What were the disbursements during that period?

A. The disbursements were interest on loans $4242.94, taxes $4310.22, Trail maintenance $1800, secretary expenses $300, and miscellaneous expenses, including office rent in the total amount of $274.

Q. What were the receipts for the period from July 1, 1935 to June 30, 1936?

A. The receipts were $9404.54, received on the Santa Cruz Lumber contract, interest on savings account $165.58, sale of junk of $158.38.

Q. Do the records indicate what junk is referred to?

A. I can ascertain in just a moment. It is machinery of shingle mill.

Q. What were the disbursements during that year?

A. The taxes were $4909.05, interest on loans $3086.50, Trail maintenance $1800, and Secretary expenses $300, and General expenses of $322.

Q. What was the balance deposited in the savings account on behalf of the company during the year ending June 30, 1933?

A. On June 30, 1933 the balance in the savings account was $33,592.86.

Q. What was that balance for the year June 30, 1934?

(Testimony of Frank C. Nelson.)

A. On June 30, 1934 the balance in the savings account was $34,434.42.

Q. What was it for the year ending June 30, 1935?

A. On June 30, 1935 the balance was $34,996.47. [27]

Q. And for June 30, 1936?

A. On June 30, 1936 the balance in the savings account was $32,162.05.

Q. Do you have with you the original minute books of the corporation? A. I have not.

Q. Will you get them, please? A. Yes.

Q. Do those books contain a complete record of all minutes of meetings of the board of directors during the period from July 1, 1932 to June 30, 1936?

A. They are the only records I have.

Q. Those are the official books that were turned over to you? A. Yes.

Q. Do they contain a record of the stockholders' meetings during that period? A. They do.

Q. Were there any meetings of stockholders?

A. From 1933 to 1936?

Q. From July 1, 1932 to June 30, 1936.

A. No minutes of any stockholders' meetings.

Q. Do those books contain the minutes of the meetings of the stockholders prior to that time?

A. Yes, they do.

Q. They are supposed to be the stockholders' minute books? A. Yes.

(Testimony of Frank C. Nelson.)

Mr. Brown: I would like to offer these original minute books in evidence as Plaintiff's Exhibit 3, under a stipulation that when Miss Phillips has had an opportunity of verifying the accuracy of the minutes as attached to the complaint we may withdraw them.

Miss Phillips: That is satisfactory.

The Court: Maybe you had better put them in as Exhibit A for identification. It is not really an exhibit, it is not going to be displayed to me. It is going to be made available, under the control of the Clerk. [28]

Mr. Brown: Copies of all of these minutes are attached to the claims for refund which are attached to the complaint, which Miss Phillips' expert can check, and when they are checked we would like permission to withdraw them.

The Court: They will be marked Plaintiff's Exhibit A for identification.

Q. Do I understand you to say they had no meetings from 1933 to 1936, inclusive, of the stockholders? A. Yes.

Q. No stockholders' meetings? A. Yes.

Q. How about the election of directors?

A. The same directors carried right through.

Q. In other words, there was an election until their successors were qualified?

A. I presume so.

The Court: Is that correct?

Mr. Brown: Yes. May it be stipulated that the minutes attached to the complaint are correct?

(Testimony of Frank C. Nelson.)

Miss Phillips: I have not seen the original minutes, but I am quite satisfied they are, but as long as they are here and filed for identification they can be checked. I think I can feel sure the books of the company were properly kept, I am not questioning the bookkeeping, but I want merely to check them.

Mr. Brown: You will stipulte unless otherwise notified they will be deemed correct?

Miss Phillips: Yes. I think it will be more satisfactory to file a written stipulation. I think that is the better way to have it, rather than in more or less nebulous form.

Mr. Brown: All right. That is all with this witness.

Cross Examination

Miss Phillips: Q. Mr. Nelson, you have stated that there [29] were no stockholders' meetings from 1932 to 1936. Do you know how many stockholders there were?

A. I have not a list of the stockholders here, Miss Phillips, so I could not say.

Q. It was a company in which the stock was closely held—most of the directors represented most of the stockholders?

A. I believe there are only five or six stockholders, but I would not be sure about that.

Q. I do not think I got some of your figures for the receipts from stumpage contracts. Can you read them back to me again?

(Testimony of Frank C. Nelson.)

A. Yes, the stumpage contracts in the year ending June 30, 1933 were $21,206.70. In the year ending June 30, 1934, $32,372.78. In the year ending June 30, 1935, $4625.93, and in the year ending June 30, 1936, $9404.54.

Q. Did you say you had the books of the company back to 1905?

A. I have the ledger which goes back to 1905.

Q. You have the ledger? A. Yes.

Q. Can you state, Mr. Nelson, briefly, whether the books show that between 1925 and 1929 there were no receipts from timber sales?

A. 1925 to 1929?

Q. Yes.

A. On April 23, 1929 I find a receipt of $10,000 from the Santa Cruz Lumber Company, deposit on a certain agreement dated April 23, 1929. The other receipts in 1929 clearly consist of interest, collection of stockholders' assessments, and some capital stock tax.

Q. That is all between 1925 and 1929?

A. Other than the $10,000—you understand that is not an audit, that is a review.

Q. Now, let us take the earlier period, take the period 1920 to 1925.

A. Here is a cash item designated "Cal. Timber Special Account, $698.89."

Q. Is that an isolated sale of timber—would you take that to [30] be that? I do not understand your reference there.

(Testimony of Frank C. Nelson.)

A. I do not understand it, either, but it represents three checks received from some small sales.

Q. That is for what year?

A. That is on January 12, 1920.

Q. Sales of timber?

A. The entry does not recite it.

Q. $698.89, January 12, 1920, from California Timber Company—it was apparently a small sale?

A. The full description is "January 8, Check Newark Lumber Company, $37.54," "January 9, San Jose Builders Supply Company, $250," and "January 12, California Timber Company, $11.35." Here is another item designated California Timber Special Account $7.50.

Q. That is in the same year?

A. That is in the same year; a similar item for $597.73.

Q. Also in 1920?

A. In March, 1920. Here is an item of $2577.90, representing a loan from the stockholders. Here is another item, Cash, California Timber Company, Special Account, $1000, described as May 7, Check Newark Lumber Company on account of pickets, 12,000 pickets at $95 per thousand; a similar item designated California Timber Special $75; another item June 20, of $83.09; another item, Loan from stockholders $872.50; another item, California Timber Company Special $137.84; another item of $494.62; another item, California Timber Company, Special on August 20, 1145.96; one on October 20

(Testimony of Frank C. Nelson.)

of $570.50; one on November 20 of $147; and loans of $2617.50. On December 7, 1920, there was an item of $15,360 from the State of California, which appears to be applied on a charge to the State of California for $38,400 for the sale of property which is accounted by a journal entry; an item in December, 1920, on the California Timber Company Special Account, $1192.75, and one of $40 on January 14, 1921; one of $400 on February 15, 1921; and $501.53 in March, 1921. [31] An item of $988.08 received from H. L. Middleton, Agent, Section 11. Another item, Credit to H. L. Middleton, Agent, Section 11, $9.08. I would not be sure whether that means Agent or Agreement. It is abbreviated, "Agt.," in both of those last two cases. Another item of Credit H. L. Middleton, Agent or Agreement, Section 11, that is $113.68. That is described as Check Milpitas Lumber Company on Bank of Milpitas for posts and pickets; cash from the State of California $3840 June 15, 1921; $1745 was received on loans on July 31, 1921.

Q. That is to say a stockholders' loan, or does it show?

A. They are all stockholders loans, all described as stockholders' loans. On July 31, 1921 there was another item of $85.40 on the Middleton item; on September 29, 1921 a receipt of $5329.40 on stockholders' loan. On October 10, 1921, $685.70 on a loan from Timothy Hopkins, Stockholder, and on November 25, 1921, $2719.90, another loan from

(Testimony of Frank C. Nelson.)

stockholders. On November 12, 1921, $1500 from H. L. Middleton, Agent, Section 11; a similarly designated item on December 1, 1921, of $137.27. A similar item on January 3, 1922 of $668.76; two other items similarly designated, $69.05 and $189.25. On March 28, 1922, an item of $39.47 from the State Compensation Insurance Fund. On May 4, 1922 $32.90 from H. L. Middleton. On July 10, 1922, $3840 from the State of California. On July 29, 1922, $1500 option on property from McCutchen, Olney, Willard, Mannon & Greene, described as Check from San Vicente Lumber Company. On September 30, 1922, $1500 credited to option on property from Mr. Timothy Hopkins check dated September 28, 1922, from San Vicente Lumber Company. A similar designated item of option on property on October 31, 1922, for $1500, one on December 1, 1922, for $1500. That is the last entry. That covers the year 1922. [32]

Miss Phillips: Your Honor, plaintiff's complaint referred to the fact that during the years 1923 to 1928, inclusive, refund claims were filed and for the capital stock tax paid to the Government for that period, and they were paid to plaintiff. The only purpose of developing this is to show the company was actually doing business in these years. The witness has carried it through 1920, 1921, and 1922. I think the testimony heretofore shows that in the years 1925 to 1929 there was no stumpage contract.

Q. Can you state from your examination of the books during the years 1923 and 1924 whether there were sales of timber going on?

(Testimony of Frank C. Nelson.)

A. I see a number of items in 1923 of $1500, option on property, the nature of which I do not know.

Q. You would not construe that to be a timber sale receipt?

A. Well, I really could not say.

Q. There is nothing to indicate that $1500 was paid for timber sold from the land?

A. The item is described this way, From Mr. Timothy Hopkins, Check to his order from San Vicente Lumber Company, by H. H. Stoddard, dated April 30, on First National Bank of Santa Cruz, ninth payment $1500. That item was on May 1, 1923, and on May 31, 1923 there was an item similarly described, and it is called the tenth payment.

Q. To shorten it a little bit, do you find any record in the year 1923 or 1924, similar to those you have testified to as having occurred in 1920, 1921, 1922, in 1924 and 1925, relating to timber or stumpage sales?

A. We are talking about the year 1923 and 1924?

Q. And 1925.

A. I could hardly say without going over the records. Do you want me to go through them?

Q. Yes.

A. These items of $1500 option on property continue [33] through here. $3840 on September 1, 1923, from the State of California; $18.42 on February 1, 1924 from the State Compensation Insurance Department.

(Testimony of Frank C. Nelson.)

Q. I am interested in the sales of timber.

A. $3840 on July 1, 1924, from the State of California. That carries it to the end of 1924. Could I just take a moment to look up an item, Miss Phillips?

Q. Mr. Nelson, I am going to ask you if you are familiar with the company's balance sheet for the years in question, 1932 to 1936.

A. Well, I would not say I was familiar with them.

Q. You have had something to do with auditing the books, haven't you? A. Only since 1937.

Q. Have you all the books in your possession now? A. Yes.

Q. Now, I am going to ask you if you could make an examination of the books, of the Profit and Loss Statement for the income during the calendar years 1932 to 1936, inclusive, and for the company's balance sheets for the same years, 1932 to 1936, and I will give you a carbon copy of each and ask you if you could make an examination of those with the books during the noon hour, or possibly we might continue this until tomorrow morning and ascertain whether those are correct copies of the income tax returns of profit and loss statements for those years and for the balance sheets for those years, and ascertain if those are correct, so that I can put a copy in evidence as my exhibit. Would it be possible to do that? A. Yes.

Miss Phillips: I will identify the first one as

(Testimony of Frank C. Nelson.)
Exhibit A, that is the Profit and Loss Statements and Exhibit B for identification, a Summary of the Balance Sheets for those years—those are for identification purposes until they are agreed to.

The Court: They may be so marked. [34]

Miss Phillips: Q. You have given us a summary of what the books show for the period of approximately nine years. I would like to have you examine your books and report to us whether it is not true that from time to time during the entire history the plaintiff company has not engaged in similar sales such as those that you have testified to on direct examination, that is, the sale of timber, standing timber, by stumpage contracts. See if the books do not show since its organization the same thing has occurred. A. Since 1906?

Q. Yes.

A. Do you want me to do that now?

Miss Phillips: I think that will be rather extended, your Honor, I think it would take a good deal of the Court's time to do it on the stand.

The Court: Have you anything further with the witness?

Miss Phillips: Not now, but I do want to ask the previous witness a question or two on some other point upon which he has testified.

The Court: Do you want the case to go over until tomorrow morning?

Miss Phillips: That is satisfactory to us.

Mr. Brown: That is satisfactory.

(Testimony of Frank C. Nelson.)

The Court: It may go over until tomorrow morning at ten o'clock.

(The further hearing of the cause was adjourned to tomorrow, Friday, February 7, 1941, at 10:00 o'clock a. m.) [35]

Friday, February 7, 1941—10:00 o'clock a. m.

FRANK C. NELSON

Cross Examination
(resumed)

Miss Phillips: Q. Mr. Nelson, since adjournment you have had an opportunity to go over the books of account of the plaintiff? A. Yes.

Q. Did you prepare the tabulation which is entitled "Statement showing a summary of sales, years 1906 to 1922, inclusive? A. Yes.

Q. You have the original, have you?

A. Yes, I have.

Q. This is taken from the company's books, and is accurate, to the best of your belief?

A. Yes, it is.

Miss Phillips: May I have this marked Defendant's Exhibit C for identification?

The Court: Yes.

Miss Phillips: Q. Mr. Nelson, taking Exhibit A for identification, a summary of profit and loss statements for the calendar years 1932 to 1936, inclusive, would you make any changes in that exhibit according to your examination of the books?

(Testimony of Frank C. Nelson.)

A. There are one or two items which should be explained.

Q. Surely, that is exactly what we want.

A. There is one item designated under income, Tanbark sales, $1455.52.

Q. That is for the year 1934?

A. Yes. This was received under the contract with the Santa Cruz Lumber Company; in other words, it was received on the same contract as the item above there designated Timber Sales. That is all on that particular schedule. You understand I have not checked every item in detail on here, but I have checked them in totals.

Miss Phillips: Then I will offer that in evidence as Defendant's Exhibit 1. [36]

The Court: It may be marked Defendant's Exhibit 1.

(The documents were marked "Defendant's Exhibit 1.")

[Defendant's Exhibit No. 1 is set out at page 224 of this printed record.]

Miss Phillips: Q. Now, the balance sheets which yesterday I offered for identification as Exhibit B, I think you want to point out some changes that you would like to make in that, do you not?

A. Yes. It should be understood that the item designated "Reserve for Depreciation" under the assets, which starts in with the amount of $12,219.88, in 1932, and continues the same amount throughout all of the years, is a credit item rather than a debit

(Testimony of Frank C. Nelson.)

item—in other words, the deduction should be shown.

Q. That is the only way you can make that add up to the figures?

A. That is right. The same remark applies to the reserve for depletion, which starts out in 1932 with $49,317.45.

Q. Will you circle with red those which are a deduction from the total receipts?

A. Not from the total receipts, but deducted from the assets.

Q. May I ask you to take a red pencil and put brackets to show how those figures are in fact treated on that?

A. Yes. Under the liability there is an amount designated "Deposit $27,749.08." Apparently there is a transposition of figures, that should be $27,479.08.

Q. There is a transposition, and it should be $27,479.08? A. Yes.

Q. Will you make that change in red pencil?

A. Yes. Then the item on there which is designated "Earned surplus"; according to my idea it should be designated "Deficit," as it is a deficit, clear across there.

Q. That is the same thing? A. Yes.

Q. In order to make that added to the total, that is to be subtracted? A. Yes. [37]

Q. Will you make that change there?

A. Yes.

(Testimony of Frank C. Nelson.)
On May 28, 1926 an option to George L. Hoxie to sell the property for $2,000,000. That option appears to have been renewed on several occasions. On September 18, 1909 it granted an option to James Jerome to sell the property for $1,600,000, and on July 3, 1916 it granted an option to W. E. Dean to sell the property for $1,250,000. Then additionally there was an occasion in 1907, April 29, where it authorizes Charles M. Felton to sell the property for $1.500,000; that does not appear to be in the way of an option, but just an authorization to sell.

Q. You referred to an option agreement in 1916 to Mr. W. E. Dean. Was he a shareholder of the corporation at that time?

A. I will have to check that. No, he does not appear to have been a stockholder at that time. Pardon me, Mr. Brown. It seems to me that there is an account of Walter E. Dean 1912½ shares, which was closed out October 7, 1910, apparently, by transfer to W. E. Dean, for a portion of those shares, and he remained a stockholder until 1927.

Q. Then according to the records Mr. Dean was a stockholder? A. Yes, he was a stockholder.

Q. Of how many shares? A. 1900 shares. [39]

Q. What was the total outstanding shares of stock? A. 10,000 shares.

Q. Mr. Nelson, referring to Defendant's Exhibit No. 1, which shows income derived during the calendar years ending December 31, from 1932 to

(Testimony of Frank C. Nelson.)

1936, inclusive, there are items designated as timber sales and tanbark sales. Were all of those receipts derived under the timber contracts with the Santa Cruz Lumber Company?

A. Yes, they were all received under the Santa Cruz Lumber Company contracts.

Mr. Brown: I think that is all from this witness.

Re-cross Examination

Miss Phillips: Q. Mr. Nelson, referring to the option to Mr. Bassett, to which you referred a moment ago, that option was granted again on May 6, 1937, was it not—a board of directors meeting on May 6, 1937? A. May 6, 1937?

Q. An option to Mr. Bassett. You have referred to an option given Mr. Bassett. Now I am asking you was not an option given again to Mr. Bassett in 1937, on May 6th?

A. I do not find where there was any option granted.

Q. Perhaps I can assist you.

Mr. Brown: Miss Phillips, Mr. Wood is informed regarding the granting of that option.

Miss Phillips: That is all right, if another witness can answer it more accurately; I will withdraw the question from the witness. That is all.

PERCY A. WOOD

recalled for further cross-examination.

Miss Phillips: Q. Mr. Wood, the question I asked the preceding witness was—he testified with

(Testimony of Percy A. Wood.)
regard to an option to [40] Mr. Bassett; he testified that an option was given in some early years, and I asked him if it was not true that an option was given Mr. Bassett in May of 1937.

A. There was an option granted to Mr. Bassett in 1937.

Q. Can you read into the record the minute upon that subject? A. Yes.

Q. Then give us your explanation.

A. It is rather lengthy, as a matter of fact. Do you want me to read the whole thing?

Q. The report of the Board of Directors on that subject. I do not believe the entire option need be read.

A. As a matter of fact, Mr. Bassett had made quite an investigation of what is known as the Pescadero side of the property, and he thought he might be able to sell that property, and asked for a 90-day option, so the matter was presented to the Board of Directors and we decided to give him a 90-day option.

Q. Will you read into the record the presentation at the Board of Directors?

A. The President stated that the principal purpose of the meeting was to consider the granting of a 90-day option to Mr. H. F. Bassett, in which the option would outline the terms on which it would be willing to negotiate for the sale of its timber land on the Pescadero watershed, such option to cover also the timber holdings on the same

(Testimony of Percy A. Wood.)
watershed of the Estate of Timothy Hopkins. The President reported that he had employed Mr. Frank Solinsky to advise the company in this matter, and that this employment was approved by the directors present. After discussion, on motion duly made and seconded, the President was authorized, by vote of all directors present, to make and enter into an agreement with H. F. Bassett in the following form.

Q. Then the option quoted a price?

A. Yes. [41]

Q. In your authorization to Mr. Basset, giving him this option, was it not agreed that there should be no negotiations with the Santa Cruz Lumber Company? A. That is correct.

Q. Because the dealings of your company with the Santa Cruz Lumber Company over a long period of years had been on such a satisfactory basis, that if a sale were made to the Santa Cruz interests no commission would go to Mr. Bassett?

A. That is correct.

Q. That was part of the option? A. Yes.

Q. Mr. Wood, in the division of the property of the company, to which you referred yesterday, was there a portion of the property on which timber was taken off consistently, and another portion on which no timber had ever been taken off?

A. Well, yesterday I referred to the contract with the Santa Cruz Lumber Company on a certain section, and that, as a matter of fact, is isolated

(Testimony of Percy A. Wood.)
from the main body of timber. On the other side, what is known as the Butano and Pescadero side, there has been no timber taken off.

Q. About how would you divide the acreage on that?

A. Well, in round figures I would say practically 12,000 acres.

Q. And the acreage which has been logged or timbered off, that is approximately 1500 to 1600 acres?

A. 1500 or 1600 or 1700 acres, something like that.

Q. Is it contemplated that eventually this 1500 or 1600 acres would be completely deforested?

A. It is completely deforested now.

Q. At what stage would you say the deforestation was completed?

A. That must have been, I would say, under these contract with the Santa Cruz Lumber Company, 1936 and 1937.

Q. So that there is no subsequent contract now outstanding? A. No. [42]

Q. What is being done with this deforested section?

A. Nothing can be done. It is a steep side hill, you could not grow anything on it, I would say it is valueless, probably worth 50 cents an acre, possibly.

Q. Is there any other section or portion of the land which it is contemplated might be sold separately from this main subdivision?

(Testimony of Percy A. Wood.)

A. There is a small section separated from the main body in what is known as Section 24, which adjoins, I would say, to the west, which might be sold separately to the State.

Q. What about Section 11? Wasn't it contemplated in that same year, March, 1937, a sale of that?

A. Section 11 could be sold separately, because it is an isolated tract of land.

Q. Isn't it true that in March, 1937 an authorization was give nto you to sell it for a price net to the corporation of $10,000 or more?

A. That is correct.

Q. That is Section 11?

A. In other words, that was given for the purpose of sale, thinking that San Mateo County might like to buy the property, because it was convenient to them.

Q. You referred to the upkeep of the trails through the property. The man whose business it was to maintain the trails was primarily for fire protection, was he not?

A. Yes, as a matter of fact we had to maintain some trails through the property, because if we had a fire men could be moved to the property to put the fire out. One of the reasons we discontinued Mr. Bennett as a caretaker, etc., is due to the fact that the County of San Mateo has made tremendous improvements in fire-fighting down there, and have built lots of trails of their own.

(Testimony of Percy A. Wood.)

Q. That is no longer necessary? A. No.

Q. Trail maintenance? A. No. [43]

Re-direct Examination

Mr. Brown: Q. Mr. Wood, what methods are available to the company for liquidating this property?

A. I don't know. The board has tried to devise methods and means and ways and given the matter considerable thought, but I don't know how it could be liquidated except either by sale to San Mateo County, or the State of California, or by eventual continuation of these logging contracts, which we do not care to do, if the State and San Mateo County want the property. There is a movement on by Lyman Wilbur, President of Stanford University, and Ex-President Hoover, and other residents of San Mateo County, to acquire this property for park purposes, because it is the only large holding of redwood timber which is left in this territory.

Q. Has the company, itself, made any effort to dispose of the property?

A. In what particular way?

Q. I was interested in the purpose for which these options had been granted. Can you explain why those options have been granted?

A. The options were granted for the purpose of endeavoring to dispose of the property as a whole.

Q. Miss Phillips referred to an option of Section 11. Is this the same Section 11 that you have referred to earlier in your testimony regarding some logging operations?

(Testimony of Percy A. Wood.)

A. Section 11, as a matter of fact, is an isolated section on which there was originally a shingle mill built.

Q. Section 11 has been cut over in part?

A. Only a very small part.

Mr. Brown: Before we conclude I would like to offer in evidence, subject to the same understanding that we had regarding earlier copies of minutes offered, copies of minutes of some of the meetings of the board of directors which deal with transactions concerning which Miss Phillips inquired. [44]

Miss Phillips: No objection.

Mr. Brown: It is understood that we will enter into a stipulation as to that after you check the accuracy of those records.

Miss Phillips: Yes.

Mr. Brown: That is all. If your Honor please, we would like to submit this case on briefs if this is satisfactory.

The Court: What time do you wish?

Mr. Brown: We would like 20 days.

Miss Phillips: That is all right with me.

The Court: And how much for you, Miss Phillips?

Miss Phillips: 20 days.

Mr. Brown: And ten days to reply?

The Court: Very well, it may be submitted on briefs to be filed 20, 20 and 10.

Miss Phillips: May the record show a motion

for judgment for the defendant upon all of the issues involved? I presume your Honor will want findings of fact and conclusions of law submitted after reaching your decision.

The Court: Yes. [45]

PLAINTIFF'S EXHIBIT No. 1

CERTIFIED COPY OF RESOLUTION.

I, the undersigned, Secretary of Santa Cruz Lumber Company, a corporation organized and existing under and by virtue of the laws of the State of California, do hereby certify that at a meeting of the Board of Directors of said corporation duly and regularly called and held at the office and principal place of business of the said corporation on March 4th, 1930, at which meeting a majority and quorum of the said directors were present and acting, the said Board of Directors did, by the unanimous vote of all directors present, duly and regularly pass and adopt the following resolution:

Resolved by the Board of Directors of Santa Cruz Lumber Company, that George N. Ley and Jas. M. Maddock, president and secretary respectively of said corporation, be and they hereby are authorized and directed to execute for and on behalf of said corporation as such officers thereof, that certain agreement presented to said Board of Directors on this date, wherein Western Shore Lumber Company, a corporation, is first party and said

Plaintiff's Exhibit No. 1 (Continued)

Santa Cruz Lumber Company, a corporation, is second party, for the purchase of certain redwood and pine timber and tan bark oak upon the terms and conditions specified in said contract or upon such modified terms and conditions as to said president and secretary shall be acceptable and said president and secretary are hereby expressly authorized and empowered to modify the terms and conditions of said contract to such extent as in their judgment may seem proper before executing the said contract for and on behalf of said Santa Cruz Lumber Company.

I further certify that said resolution has never been amended, revoked or set aside and is now in full force and effect.

In witness whereof, I have hereunto subscribed my name and affixed the seal of said corporation this 5th day of March, 1930.

[Seal] JAS. M. MADDOCK

Secretary of Santa Cruz
Lumber Company.

This agreement, made and entered into this 10th day of March, 1930, by and between Western Shore Lumber Company, a corporation organized and existing under and by virtue of the laws of the State of California, first party, and Santa Cruz Lumber Company, a corporation organized and existing under and by virtue of the laws of the State of California, second party,

Plaintiff's Exhibit No. 1 (Continued)

Witnesseth:

That, whereas, first party is the owner of the following described timber lands, to-wit:

> All those certain lots, pieces or parcels of land situate, lying and being in the County of San Mateo, State of California, and more particularly described as follows, to-wit:
>
> All of Section Twenty One (21); all of Section Sixteen (16); and the West half (W½) of the Northwest quarter (NW¼) of Section Fifteen (15); all in Township Eight (8) South, Range Three (3) West, Mount Diablo Base & Meridian;

and

Whereas, second party desires to acquire the right to cut, fell and remove the redwood and pine timber and the tanbark on said timber lands as hereinafter provided;

Now, therefore, in consideration of the premises and of the sum of forty thousand (40,000) dollars in cash to first party in hand paid by second party concurrently with the execution of these presents the parties hereto hereby mutually agree as follows:

(1) (a) As long as second party shall make the payments and keep and perform the agreements, covenants, terms and conditions herein contained on its part to be kept and performed, the second party shall have and is hereby granted during the term hereinafter provided the right to cut, fell and remove from the said Section Twenty One

Plaintiff's Exhibit No. 1 (Continued)

(21) all the merchantable redwood and pine timber and tanbark oak (hereinafter referred to as tanbark) growing, standing or being thereon, for the prices hereinafter provided; and for the purpose of cutting, felling and removing said timber and tanbark, second party shall have possession of said Section Twenty One (21) for the term hereinafter provided and shall have the right during such term to cut out and construct roads over and across the same; but all such rights, roads and rights of way therefor shall automatically terminate upon the expiration or sooner termination of the right of second party hereunder to cut and fell and log timber thereon. The second party shall also have and there is hereby granted to it a right of way for one railroad aver and across Sections Sixteen (16) and Twenty One (21) and such parts of Sections Fifteen (15) and Twenty Two (22) as belong to first party, said Township and Range, for use in lumbering under this agreement, and also for use in lumbering by the second party upon Section Twenty Eight (28), said Township and Range, or any other timber or timber lands in the general neighborhood it may now own or hereafter acquire, with the right to relocate said railroad from time to time in part or in whole, and to remove the ties and rails placed thereon. Said right of way and right of removal, so far as necessary or useful in lumbering under this agreement, shall expire and terminate one (1) year after the expiration or sooner ter-

Plaintiff's Exhibit No. 1 (Continued)

mination of the time herein provided for the lumbering operations in which said railroad is used, but as to so much of said railroad as is or may be used in lumbering upon said Section Twenty Eight (28), or other lands or timber of the second party, the right of way herein granted therefor and the right of removal of ties and rails shall continue in full force for ten (10) years from the date hereof, and shall then automatically expire, and no previous expiration or termination of this agreement shall have the effect of terminating such last mentioned right of way before the end of said ten (10) year period. All ties and rails left upon any such right of way after the termination of such right of way and right of removal shall belong to the first party.

(b) If second party shall duly and regularly make all payments and keep and perform all agreements, covenants, terms and conditions herein contained on its part to be kept and performed, during the period of time herein allowed to complete the cutting of all such timber and tanbark on said Section Twenty One (21), and if at the time such cutting is completed, first party is satisfied in its sole discretion with the character, method and manner in which such cutting was done, and is in its sole discretion satisfied with the condition in which said Section Twenty One (21) is then left, then second party shall have and is hereby granted the same right to cut, fell and remove merchantable redwood

Plaintiff's Exhibit No. 1 (Continued)

and pine timber and tanbark from said Section Sixteen (16) and the West half ($W\frac{1}{2}$) of the Northwest quarter ($NW\frac{1}{4}$) of said Section Fifteen (15) as is hereinabove granted to it in respect to such timber and tanbark on said Section Twenty One (21). All the provisions of this agreement hereinafter set forth shall apply to all operations of second party, whether upon or connected with timber cut from said Section Twenty One (21), or upon or connected with timber cut from said Section Sixteen (16) and/or said portion of said Section Fifteen (15), unless herein otherwise expressly provided; but it is expressly understood and agreed that unless first party is satisfied in its discretion as aforesaid, then notwithstanding second party shall not be in default hereunder at the time, it shall have no right to cut, fell or remove timber from said Section Sixteen (16) or said portion of said Section Fifteen (15), or any rights in or to the said timber lands or the timber or tanbark thereon whatsoever.

(2) The price or prices payable by second party to the first party for the said rights to cut, fell and remove said timber and tanbark shall be the following:

(a) An amount based upon the timber and tanbark cut, felled and/or removed by second party at the rate of four (4.00) dollars per thousand feet, board measure, in the case of redwood and pine timber, and at the rate of five (5.00) dollars per

Plaintiff's Exhibit No. 1 (Continued)

cord in the case of tanbark, payable monthly to the first party at its office in San Francisco on the fifteenth day of each and every month for all pine and redwood lumber sawed at the mill of second party and for all tanbark felled and delivered to a tannery by the second party during the preceding calendar month.

(b) If at the expiration of the time herein allowed to complete cutting timber and tan bark upon said Section Twenty One (21), the second party shall have completed such cutting, and shall have at all times made all payments and in all other respects kept and performed all agreements, covenants, terms and conditions herein contained on its part to be kept or performed, but the first party shall not in its discretion be satisfied as provided in paragraph (1) (b) hereof, so that the second party is not permitted to cut timber or tanbark upon said Section Sixteen (16) or said portion of said Section Fifteen (15), then the first party shall thereupon pay to the second party the sum of forty thousand (40,000) dollars, and thereupon this agreement and all rights and obligations of the parties hereunder shall terminate and be at an end.

(c) If the second party shall be permitted under this agreement the right to cut timber and tanbark upon said Section Sixteen (16) and said portion of said Section Fifteen (15) as provided in paragraph (1) (b) of this agreement, then and in such event, if the second party shall during the entire remain-

Plaintiff's Exhibit No. 1 (Continued)

ing term of this agreement make all payments and keep and perform all agreements, covenants, terms and conditions herein contained on its part to be kept and performed, the first party shall allow to the second party a credit of forty thousand (40,000) dollars upon the last forty thousand (40,000) dollars becoming payable hereunder to the first party, as determined by estimate of the remaining uncut timber and tanbark to be agreed upon between the parties hereto one year before the completion of the entire cut; or if the parties hereto are unable then to agree, to be fixed and determined by the decision of a competent timber man or cruiser to be selected by them; but until such estimate is so made, the second party shall be required to continue monthly payments hereunder. In the event that at the time such estimate is so made the remaining uncut timber and tanbark shall be insufficient in value to equal said credit of $40,000 at the rates to be paid for said timber and tanbark as hereinbefore specified, the amount of such deficiency in value shall thereupon be paid by first party to the second party.

(3) The determination of the number of thousand feet, board measure, of redwood and pine timber cut, felled and removed by the second party shall be made by a tally at the tail end of the mill of second party. If first party shall so elect, said tally shall be made by a tallyman mutually agreed upon by the parties, or appointed by the first party, and the expense of the employment of such tally-

Plaintiff's Exhibit No. 1 (Continued)

man for the purpose of the tally shall be divided equally between the parties. The determination of the amount of tanbark cut by second party shall be made by scale weights of tanbark determined at the tannery to which such tanbark is sent, and if first party shall so elect, shall be made by a person agreed upon between the parties or appointed by first party, and the expense of the employment of such person for such purpose shall be borne equally by the parties.

(4) First party shall have the right at any time through its officers, agents or representatives to inspect the operations of the second party on the said timber lands and the method of tallying hereinabove provided for. First party shall also have the right at any time through its officers, agents or representatives to examine the books of account of second party and all other records of second party covering the operations of said second party on the said timber lands of first party.

(5) The second party shall from and after the date of this agreement proceed diligently with the cutting, felling and removing of said timber and tanbark from the said Section Twenty One (21) and shall saw such timber into lumber at its sawmill in Section Twenty Seven (27), Township Eight (8) South, Range Three (3) West, and shall within four (4) years from the date of this agreement cut, fell and remove from said Section Twenty One (21) all merchantable redwood and pine tim-

Plaintiff's Exhibit No. 1 (Continued)

ber and all tanbark thereon, and within said period saw into lumber all such timber and deliver to a tannery or tanneries all such tanbark. Unless this agreement shall be theretofore or then terminated either in pursuance of the right of first party as provided in paragraph (1) (b) hereof if it be not satisfied in its discretion, or by reason of default hereunder of the second party, the second party shall and it hereby agrees that it will, upon completing the said cutting upon said Section Twenty One (21), but not prior thereto, begin and thereafter diligently proceed with the cutting, felling and removing of said timber and tanbark from said Section Sixteen (16) and said portion of said Section Fifteen (15), and shall within eight (8) years from the date of this agreement cut, fell and remove from said last mentioned timber lands all merchantable redwood and pine timber and all tanbark thereon, and saw into lumber all such timber and deliver to a tannery or tanneries all such tanbark, it being expressly understood that if permitted so to do by the first party, the second party shall be obliged hereunder, and agrees, to cut, fell and remove all such timber and tanbark and to saw all such timber into lumber and deliver to a tannery or tanneries all such tanbark as aforesaid. Upon the expiration of the said eight (8) years from the date hereof, all further rights of said second party in and to said timber and tanbark on the lands of the first party, and all rights of the second party

Plaintiff's Exhibit No. 1 (Continued)

in and to said lands, other than the railroad right of way hereinbefore granted, shall cease and determine, and the first party shall have the exclusive right and possession of same and of any timber or tanbark remaining thereon.

(6) The legal title to all timber and tanbark upon the lands of the first party, covered by this agreement, shall remain in first party until the same be cut, felled and removed by second party and after such cutting, felling and removal, the legal title to and the right of possession of the same and of any lumber manufactured therefrom shall be and remain in the first party as security for any portion of the purchase price hereinabove provided which may then remain due and unpaid until the same shall have been fully paid; and second party agrees at all times to keep on hand a sufficient quantity of said timber, tanbark and lumber separately piled to secure the balance owing, if any, to first party; and in case of default by second party in making any of the payments hereunder and in performing any of the conditions hereof, first party shall, in addition to other rights in such case provided, have the right to take immediate possession of said timber, tanbark and lumber, and to sell and dispose of same at public or private sale, without notice to the second party, for the purpose of satisfying the balance due under this contract and all costs and expenses in taking, keeping and disposing of said property. So long as the second party shall not be

Plaintiff's Exhibit No. 1 (Continued)

in default hereunder and shall be entitled to proceed with the cutting of timber hereunder, it shall have the privilege of piling at its own risk upon the flat on Section 22, said Township and Range, belonging to the first party and adjoining the mill of the second party on Section 27, said Township and Range, the lumber of the first party cut and sawed under this agreement.

(7) Second party agrees to so conduct its operations upon said lands above described in accordance with good current timbering practice in use in similar redwood lumbering in California, and so as not to damage unnecessarily any young growth or trees left standing by second party, and not to damage in any way any buildings or improvements on said lands.

(8) All slash and cuttings resulting from operations of second party on the lands herein described may be sold by first party for fuel, or other purposes, if first party so elects, but if first party does not so elect, second party agrees to burn the same during the proper season when no danger of forest fire will result. The second party agrees that it will construct good and sufficient firebreaks and fire trails to prevent spreading of fire from the lands of the first party upon which the second party is operating to other timber lands of the first party, and in particular to prevent the spreading of fire from said Section Twenty One (21) to said Section Sixteen (16).

Plaintiff's Exhibit No. 1 (Continued)

(9) Second party agrees to indemnify and to save and hold first party harmless of and from any and all liens and claims whatsoever arising from its operations on said lands of first party. Second party further agrees that first party shall not be liable or responsible for any accidents, loss, injury, or damage happening, or accruing, in connection with, or anywise arising out of the work herein referred to, or any of the operations of second party hereunder to persons and/or property (whether employed upon or utilized in said work, or otherwise, and including the death of any persons) and second party agrees to fully indemnify and save and hold first party harmless of, from and against the same and any and all liability, expenses (including attorneys' fees) payments, claims and/or liens whatsoever therefor.

(10) During the term of this agreement second party agrees to do all in its power to prevent and suppress fires on the lands hereinabove described and in the vicinity and to require its employees to do likewise. In the event that any fire shall start on the lands above described, or in its vicinity, second party agrees to place all its employees in that logging area at work in fighting such fire and to keep them constantly and continuously at work fighting such fire until it shall be extinguished.

(11) No assignment of this agreement shall be made by second party either voluntarily or by operation of law, proceedings in bankruptcy, or otherwise, without the written consent of the first party

Plaintiff's Exhibit No. 1 (Continued)

and any such attempted assignment without such written consent shall be null and void.

(12) In the event that second party shall make default in the payment of any amount due under this contract, as hereinabove provided, or in the performance or observance of the terms, conditions and agreement herein contained on its part to be performed or observed, first party may at its option, upon fifteen (15) days written notice of such default to second party, treat this agreement as terminated without further notice given to second party if within said fifteen (15) days such default be not cured, and thereupon this agreement shall become null and void, and the rights of second party shall come to an end, and second party shall have no further right, title and interest, claim or demand whatsoever, under or by virtue of this agreement in or to the timber lands hereinabove described, or the timber or tanbark thereon, or in or to said sum of forty thousand (40,000) dollars paid concurrently herewith, it being expressly understood and agreed that the said sum is paid to and received by the first party concurrently with the execution of this agreement as and for an essential part of the consideration running to the first party for entering into this agreement, and is made as a payment to the first party for the rights herein granted to the second party, and not as a security. Nothing herein contained shall be construed as depriving first party of any right to any other right or remedy to which it may be

Plaintiff's Exhibit No. 1 (Continued)

entitled at law or in equity on the happening of such default.

(13) Time is hererby agreed to be of the essence of this agreement and of all of its provisions.

(14) Any notice which it is herein provided may or shall be given by either party to the other shall be deemed to have been duly given when deposited in the United States mail in San Francisco or Santa Cruz, California, postage prepaid and registered, addressed to the party to whom such notice is given at the following respective addresses:

To the first party at:

905 Kohl Building
San Francisco, California

To the second party at

84 River St.,
Santa Cruz, California

Either party by notice given as hereinbefore provided may change the address to which notices to it shall thereafter be addressd.

(15) Subject to the provisions of paragraph (11) above, this agreement shall bind and shall inure to the benefit of the successors and assigns of the respective parties hereto.

In Witness Whereof the parties have caused their respective corporate names to be hereunto subscribed and their respective seals to be hereunto affixed by their respective officers thereunto

Plaintiff's Exhibit No. 1 (Continued)

duly authorized, all in duplicate, the day and year first above written.

[Corporate Seal]

WESTERN SHORE LUMBER COMPANY
TIMOTHY HOPKINS,
Pres.
By WALTER L. DEAN,
Sect'y.

[Corporate Seal]

SANTA CRUZ LUMBER COMPANY
By GEORGE W. LEY,
President
By JAS. M. MADDOCK,
Sect'y.

State of California,
County of Santa Cruz, ss.

On this 11th day of March in the year one thousand nine hundred and thirty, before me, Esther Spangenberg, a Notary Public in and for the County of Santa Cruz, State of California, residing therein, duly commissioned and sworn, personally appeared George N. Ley and Jas. M. Maddock known to me to be the President and the Secretary respectively of the corporation described in and that executed the within instrument, and also known to me to be the persons who executed the within instrument on behalf of the corporation therein named, and acknowledged to me that such corporation executed the same.

In witness whereof, I have hereunto set my hand and affixed by official seal at my office in the County of Santa Cruz, the day and year in this certificate first above written.

[Seal] ESTHER SPANGENBERG

Notary Public in and for the County of Santa Cruz, State of California.

[Endorsed]: Filed Feb. 6, 1941.

PLAINTIFF'S EXHIBIT NO. 2

CERTIFIED COPY OF RESOLUTION

I, the undersigned, Secretary of Santa Cruz Lumber Company, a corporation organized and existing under and by virtue of the laws of the State of California, do hereby certify that at a meeting of the Board of Directors of said corporation duly and regularly called and held at the office and principal place of business of the said corporation on January 17th., 1936, at which meeting a majority and quorum of the said directors were present and acting, the said Board of Directors did, by the unanimous vote of all directors present, duly and regularly pass and adopt the following resolution:

Resolved by the Board of Directors of the Santa Cruz Lumber Company, that George N. Ley and Jas. M. Maddock, president and secretary respectively of said corporation, be and they hereby are authorized and directed to execute for and on behalf of said corporation as such officers thereof, that cer-

tain agreement presented to said Board of Directors on this date, wherein Western Shore Lumber Company, a corporation, is first party and said Santa Cruz Lumber Company, a corporation, is second party, for the purchase of certain redwood and pine timber upon the terms and conditions specified in said contract or upon such modified terms and conditions as to said president and secretary shall be acceptable and said president and secretary are hereby expressly authorized and empowered to modify the terms and conditions of said contract to such extent as in their judgment may seem proper before executing the said contract for and on behalf of said Santa Cruz Lumber Company.

I Further Certify that said resolution has never been amended, revoked or set aside and is now in full force and effect.

In Witness Whereof, I have hereunto subscribed my name and affixed the seal of said corporation this 17th day of January, 1936.

JAS. M. MADDOCK,
Secretary of Santa Cruz
Lumber Company.

This Supplemental Agreement made and entered into this 17th day of January, 1936, by and between Western Shore Lumber Company, a corporation organized and existing under and by virtue of the laws of the State of California, first party, and Santa Cruz Lumber Company, a like corporation, second party,

Witnesseth:

That Whereas, first party and second party made and entered into an agreement, dated March 10, 1930, under which second party was granted the right, for the considerations and upon the terms and conditions therein provided, to cut, fell and remove certain timber on said lands therein particularly described; and

Whereas, the said agreement is still in effect between the parties hereto; and

Whereas, first party is the owner of the following described timber lands in addition to those described in the said agreement of March 10, 1930:

> All those certain lots, pieces or parcels of land situate, lying and being in the County of San Mateo, State of California, and more particularly described as follows, to wit:
>
> The East Half and the East Half of the West Half of Section 22, Township 8 South, Range 3 West;

and

Whereas, the parties hereto desire to amend the said agreement of March 10, 1930, to include the lands hereinabove described thereunder and provide for the particular price to be paid for timber growing on said lands;

Now, Therefore, in consideration of the premises and of the mutual agreements herein contained, the parties hereby agree that said agreement of March

10, 1930, be and it is hereby amended as follows:

1. The lands described in the said agreement shall include, in addition to those therein particularly described, the parcels of land hereinabove in this supplemental agreement particularly described, and second party shall have the right to cut, fell and remove the redwood and pine timber on the lands in this supplemental agreement particularly described upon the same terms, conditions and provisions applicable to the lands therein particularly described except as herein amended.

2. The lands in this supplemental agreement particularly described shall be treated as in the same class as Section 16 and the portions of Section 15, in Township 8 South, Range 3 West, Mount Diablo Base and Meridian, described in said agreement of March 10, 1930, and all provisions of said agreement applicable to said Section 16 and portions of said Section 15 shall apply to the portions of said Section 22 described in this supplemental agreement.

3. The price payable by second party to first party for the timber cut, felled and/or removed by second party from any portion of said Section 22 described in this supplemental agreement shall, however, be Two Dollars ($2.00) per thousand feet, board measure instead of Four Dollars ($4.00) per thousand feet, board measure, as provided in Section 2, subdivision (a), of said agreement of March 10, 1930, but all other provisions of said section and subdivision shall apply unchanged to the said portions of said Section 22. The said price of Four Dollars

($4.00) per thousand feet, board measure shall still apply to all timber cut, felled and/or removed from any other lands under said agreement of March 10, 1930.

4. Except as herein expressly amended, the said agreement of March 10, 1930, shall remain in full force and effect between the parties hereto.

In Witness Whereof, the parties have caused their respective corporate names to be hereunto subscribed and their respective seals to be hereunto affixed by their respective officers thereunto duly authorized, all in duplicate, the day and year first above written.

[Corporate Seal]

WESTERN SHORE LUMBER COMPANY

By A. CRAWFORD GREENE

Vice President

By MYRA LANE

Secretary

[Corporate Seal]

SANTA CRUZ LUMBER COMPANY

By GEORGE M. LEY

President

By JAS. M. MADDOCK

Secty.

[Endorsed]: Filed Feb. 6, 1941.

PLAINTIFF'S EXHIBIT No. 3

Minutes of Meeting of Board of Directors
San Francisco, April 23, 1910.

Written notices having been forwarded to each member of the board, there were present Messrs. Hopkins, Dean, Felton, Thorne and Middleton.

President Hopkins in the chair.

The Minutes of the last meeting of the board were then read, and on motion duly seconded, they were approved as recorded.

On motion of Mr. Dean, seconded by Dr. Thorne, It was Resolved

That the office of this Company be, and it is hereby removed from No. 516 Kohl Building, San Francisco, to Room 905 in the same building.

Mr. Middleton of the Committee to whom had been referred the matter of the Claim of this Company against Hubbard and Carmichael, reported that up to the present time, there had not been a satisfactory adjustment of the claim.

The President then stated that for the purpose of meeting the present obligations of the company, paying the second installment of taxes, now due, and meeting the current expenses in the near future, some action should be taken to provide the necessary funds. He stated that it had been suggested that it would be advisable to sell from some selected section of the Company's property, the tan bark, oak wood, pickets and other products, rather than to Assess the Stockholders,

Plaintiff's Exhibit No. 3—Continued

Whereupon, On motion of Mr. Felton seconded by Mr. Dean,

It was Resolved:

That Mr. H. L. Middleton be appointed a committee of one, to look into the matter and ascertain which section of Land would be advisable to have cash off; what would be the probable cost of the work to be done, and the value of the tan bark, wood, etc., when it should be marketed;—and to report at a future meeting of the Board of Directors to be called by the President.

There being no further business, On motion the meeting adjourned.

D. C. BATES,
Secretary.

Minutes of Meeting of Board of Directors
San Francisco, May 5, 1910

Written notices having been forwarded to each member of the Board, there were present Messrs. Hopkins, Dean, Felton, Thorne and Middleton.

President Hopkins in the chair.

On motion of Mr. Felton, the reading of the minutes of the last meeting was postponed.

Mr. Middleton presented his report in relation to the taking off Tan Bark, Shakes, etc., from some portion of the Company's property.

The Report is hereunto attached and made a part of this record.

Plaintiff's Exhibit No. 3—Continued

Letterhead of
Santa Clara Valley Mill & Lumber Company
H. L. Middleton, Manager

San Francisco, California
May 4th, 1910.

Mr. Timothy Hopkins,
President Western Shore Lumber Co.,
San Francisco, Cal.

Dear Sir:

Have had estimate made for getting out tan bark from lands of Western Shore Lumber Company in San Mateo County.

From 300 to 600 cords to come from Section 2 and 35 T 7 & 8 on Pescadero and 600 to 1000 cords to come from the Butano section 19 T. 8 S. R. 3 W. The net freight on the bark will be from $9.00 to $10.00 per cord.

Bloomquist Bros. of Pescadero have offered to peel, pack and deliver by team from the Pescadero to Beegers Tannery at Redwood City for $12.00 per cord and Beegers Tannery offer us $22.65 per cord, this would leave a net profit of $10.65 per cord. Will try to get a lower figure on delivery of bark.

On bark to come from Section 19 on the Butano estimates show a net profit of from $9.00 to $10.00 per cord, we still have men looking over the land and may expect bids by May 9th.

The present freight rate on bark to San Francisco is $2.90 a cord, have put in an application to S. P. Co. to reduce this rate to $2.00 per cord.

Plaintiff's Exhibit No. 3—Continued

I would suggest that we take off same lands from which we take the bark 500,000 to 1,000,000 shakes. The shakes will pay a profit of not less than $10.00 per M Ft board measure. In making the shakes it is advisable to work portions of the tree that will not make shakes into pickets, posts and grape stakes.

Will have a further report in a week or ten days.

Yours truly,

[Signed] H. L. MIDDLETON.

On motion of Mr. Felton, seconded by Mr. Dean,

It was Resolved,

That the Report be accepted, and that Messrs. Hopkins and Middleton be appointed a Committee, to take the necessary steps to carry out the plan as presented in the Report.

It being stated by Mr. Middleton that such money as would be required to carry on the proposed work could be borrowed by this company from Banks in San Jose and Santa Clara, at interest of six per cent per annum.

On motion of Mr. Dean seconded by Dr. Thorne,

It was Resolved,

That the President and Secretary of this company are hereby authorized to sign and deliver the promissory notes of the Company, from time to time, in such amounts as may be required, not exceeding in all the sum of twenty five thousand Dollars, to bear interest at six per cent.

Plaintiff's Exhibit No. 3—Continued

The Committee to whom had been referred the matter of the claim against Hubbard and Carmichael reported progress and were granted further time.

There being no further business, on motion the meeting adjourned.

D. C. BATES
Secretary

Minutes of Meeting of Board of Directors
San Francisco, May 24, 1916.

Written notice having been forwarded to each of the surviving members of the Board,

There were present:

Messrs. Timothy Hopkins, W. E. Dean and H. L. Middleton.

Absent: Mr. Charles N. Felton Jr.

President Hopkins in the Chair.

The minutes of the last meeting were read, and on motion, approved as recorded.

There being a vacancy in the Board of Directors caused by the death of our esteemed associate, Hon. Charles N. Felton, it was moved and carried that Mr. Walter L. Dean be elected to fill the vacancy so caused.

Mr. Walter L. Dean being present took his seat in the Board.

The President then stated that the purpose of the meeting was to consider the clearing of the Company's Section 11, Township 8 South Range 3 West

Plaintiff's Exhibit No. 3—Continued

M.D.B. and M. of the timber, tanbark, etc.

Whereupon, On Motion duly Seconded, it was Resolved:

That Mr. H. L. Middleton be and he is hereby authorized and empowered to take the necessary steps toward that end, and to the marketing the product from said Section 11 for and in the behalf and interest of this Company.

There being no further business the meeting adjourned.

D. C. BATES
Secretary

Special Meeting of the Board of Directors
San Francisco, August 23, 1920.
11 o'clock A. M.

Special meeting of the Board of Directors, called by order of the President was held at the office of the Company.

There were present:

Messrs. Timothy Hopkins, W. E. Dean, H. L. Middleton and Walter L. Dean.

President Hopkins in the chair.

On Motion duly Seconded, the reading of the Minutes of the last Meeting was dispensed with.

On Motion of Mr. W. E. Dean, Seconded by Mr. H. I. Middleton, Mrs. D. C. Bates was duly elected a Member of the Board of Directors, to fill the vacancy caused by the decease of Mr. C. N. Felton, and Mr. Bates being present immediately took his seat as Member of the Board of Directors.

Plaintiff's Exhibit No. 3—Continued

President Hopkins stated that the business to come before the Meeting was a proposition to sell certain real property to California Redwood Park Commission of the State of California.

Director Mr. W. E. Dean then offered the following Resolution:

> "Resolved, That this corporation enter into an agreement to sell to California Redwood Park Commission of the State of California that certain real property situate in the County of Santa Cruz, State of California, particularly described as follows:
>
> "The east one-half (E½) of section thirty-one (31) and the southwest one-quarter (SW¼) of section twenty-nine (29), all in township eight (8) south of range three (3) west, Mount Diablo Base and Meridian, for the total price of thirty-eight thousand four hundred (38,400) dollars in lawful money of the United States, upon the terms and conditions contained in the agreement hereinafter in this resolution set forth.
>
> Resolved Further, That this corporation execute and deliver to said California Redwood Park Commission of the State of California an agreement for the sale of said real property, which said agreement is in the words and figures following:

This Indenture, made this 23rd day of August, A. D., 1920, by and between California Redwood

Plaintiff's Exhibit No. 3—Continued

Park Commission of the State of California, as party of the first part, and Western Shore Lumber Company, a corporation, as party of the second part,

Witnesseth:

That the said party of the first part, pursuant to the authority conferred upon it by the provisions of that certain act of the legislature of the State of California, entitled "An Act providing for the enlargement of the California redwood park, making an appropriation for the purchase of additional land therefor, and granting power to the California redwood park commission to purchase the same," approved May 28, 1917, has agreed and does hereby agree to the purchase of and from the said party of the second part, and the said party of the second part has agreed and does hereby agree to sell unto the said party of the first part, all that certain real property situate, lying and being in the county of Santa Cruz, State of California, and particularly destribed as follows, to-wit:

The East one-half (E.½) of Section thirty-one (31), and

The Southwest one-quarter (S.W.¼) of Section twenty-nine (29), all in Township Eight (8) South of Range Three (3) West, M.D.B.&M., upon the terms and conditions following, to-wit:

1. The agreed purchase price of the above described real property is the sum of thirty-eight thousand four hundred (38,400) dollars, lawful

Plaintiff's Exhibit No. 3—Continued

money of the United States, of which the sum of eleven thousand five hundred and twenty (11,520) dollars shall be payable to said second party immediately upon the due execution and delivery to said first party by said second party of a good and sufficient deed conveying to the State of California the fee simple title to said real property and the whole thereof. The residue of said purchase price shall be paid in seven equal annual installments of three thousand eight hundred and forty (3,840) dollars each, falling due on the first day of July, A. D., 1920, and upon each succeeding anniversary thereof until the whole of said agreed purchase price shall be fully paid, all such payments to be made from the amount appropriated for such purpose by the provisions of the above entitled act. Such deferred payments shall draw no interest. And, in this behalf, said first party hereby agrees that, upon the delivery and acceptance of such deed, it will, in writing, authorize and request the Controller of the State of California annually to draw and deliver his warrants against said fund, upon the first days of July, A. D., 1920, 1921, 1922, 1923, 1924, 1925 and 1926 for the said sum of three thousand eight hundred and forty (3,840) dollars each, made payable to said second party, its successors in interest and assigns.

II. Said second party agrees that it will, without unnecessary delay, deliver to the Attorney General of the State of California suitable abstracts

Plaintiff's Exhibit No. 3—Continued

of title showing that it has a good and valid title to the above described real property, and the whole thereof, free from any valid liens or encumbrances. The cost of any proceedings which may be found necessary to remove any minor defects or clouds affecting such title shall be borne by said second party. Upon the initial payment of such purchase price being made as above provided, such abstracts shall become the property of the State of California.

In Witness Whereof, the said parties hereto have caused these presents to be executed, in duplicate, by their respective officers, thereunto duly authorized, the day and year hereinabove first written.

CALIFORNIA REDWOOD
PARK COMMISSION

By ....
President

Attest: ....Secretary

WESTERN SHORE LUMBER
COMPANY, a corporation,

By ....
President

Attest: ....Secretary

The foregoing agreement is hereby approved, this .... day of ...., 1920.

Members of State Board
of Control.

Plaintiff's Exhibit No. 3—Continued

The foregoing agreement is hereby approved as to form this .... day of ...., 1920.

....

Attorney General of the State of California.

Whereas, under and by virtue of the provisions of that certain act of the legislature of the State of California, entitled "An Act providing for the enlargement of the California redwood park, making an appropriation for the purchase of additional land therefor, and granting power to the California redwood park commission to purchase the same, approved May 28, 1917, California Redwood Park Commission was and is empowered and authorized to purchase land contiguous to California redwood park and suitable for the enlargement thereof; and

Whereas, pursuant to such power and authority and to the provisions of said act, California Redwood Park Commission has heretofore purchased of and from Western Shore Lumber Company, a corporation, certain lands contiguous to said park, as the same existed at the date of said act, suitable for the enlargement thereof, situate, lying and being in the county of Santa Cruz, State of California, and particularly described as follows, to-wit:

The East one-half (E.½) of Section thirty-one (31), and

The Southwest one-quarter (S.W.¼) of section twenty-nine (29), all in Township Eight (8) South of Range Three (3) West, M.D.B.&M.; and

Plaintiff's Exhibit No. 3—Continued

Whereas, the agreed purchase price of said lands was and is the sum of thirty-eight thousand four hundred (38,400) dollars, of which the sum of eleven thousand five hundred and twenty (11,520) dollars was heretofore paid to said vendor upon the delivery by it of a good and sufficient deed conveying to the State of California the fee simple title to the above described real property and the whole thereof; and

Whereas, there remains unpaid of said purchase price the aggregate sum of twenty-six thousand eight hundred and eighty (26,880) dollars, which shall become payable to said vendor in seven equal annual installments of three thousand eight hundred and forty (3,840) dollars each, falling due on the first day of July, 1920, and upon each succeeding anniversary thereof until the unpaid residue of said purchase price be fully paid and discharged:

Now, Therefore, in consideration of the premises,

Be It Resolved: That California Redwood Park Commission Hereby assigns, transfers and sets over unto said Western Shore Lumber Company, its successors in interest and assigns, the said sum of twenty-six thousand eight hundred and eighty (26,880) dollars out of the total amount appropriated by said statute; and

Be It Further Resolved: That the Controller of the State of California, be, and he hereby is, authorized and requested annually to draw and deliver his warrants against the sum so appropriated upon the

Plaintiff's Exhibit No. 3—Continued

first days of July, A. D., 1920, 1921, 1922, 1923, 1924, 1925, and 1926, for the said sum of three thousand eight hundred and forty (3,840) dollars each, made payable to said Western Shore Lumber Company, its successors in interest and assigns; and

Be It Further Resolved: That the Secretary of this Commission be and he is authorized and directed to deliver to said Western Shore Lumber Company an original signed duplicate of the foregoing preambles and resolutions, and to deliver certified copies thereof to the State Controller, to the State Treasurer and to the State Board of Control.

I, ------------------, hereby certify that I am, and at all times herein mentioned have been, the Secretary of California Redwood Commission of the State of California; that the foregoing is a full, true and correct copy of a resolution adopted at a meeting of said Commission, held at Sacramento, California, on the -------- day of ------------, 1920; that said meeting was regularly called and held pursuant to law, and all of the Commissioners were present at said meeting; and that said resolution was duly passed and adopted, has never been revoked, annulled or set aside, and is still in full force and effect.

I further certify that at the date of the adoption of said resolution, and at the date of the execution of said agreement, --------------------, was and is the President of said Commission.

Plaintiff's Exhibit No. 3—Continued

In Witness Whereof, I have hereunto set my hand this -------- day of ------------, 1920.

Secretary of California

Redwood Park Commission.

Resolved Further, That the president or vice-president and the secretary of this corporation be and they hereby are, authorized, in the name of and on behalf of this corporation, and under its corporate seal, and as its act and deed, to make, execute and deliver said hereinbefore recited agreement to California Redwood Park Commission of the State of California."

Upon motion duly made and seconded, said resolution was unanimously adopted, each director present voting in favor thereof.

Thereupon, Director W. E. Dean offered the following resolution:

"Whereas, California Redwood Park Commission of the State of California has offered to buy of and from this corporation the property described in the following resolution, for the total price of thirty-eight thousand four hundred (38,400) dollars, of which three-tenths (3/10) shall be paid forthwith, and the balance in seven (7) annual installments of one-tenth (1/10) each, the first installment thereof falling due on the first day of July, 1920, and the last installment thereof falling due on the first day of July, 1926;

Plaintiff's Exhibit No. 3—Continued

And, Whereas, said offer is conditioned upon the execution and delivery by this corporation of a deed conveying said real property to the State of California, therefore,

Be It Resolved, That this corporation make, execute and deliver to the State of California deed of grant, bargain and sale conveying to the State of California, all that certain real property situate in the County of Santa Cruz, State of California, and particularly described as follows:

The east one-half (E½) of section thirty-one (31) and the southwest one-quarter (SW¼) of section twenty-nine (29), all in township eight (8) south of range three (3) west, Mount Diablo Base and Meridian.

And Be It Further Resolved, That the president or vice-president and the secretary of this corporation be and they hereby are authorized, in the name of and on behalf of this corporation, and under its corporate seal, and as its act and deed, to make, execute and deliver said hereinbefore mentioned deed to the State of California."

Upon motion duly made and seconded, said resolution was unanimously adopted, each director present voting in favor thereof.

There being no further business to come before the meeting, it was duly adjourned.

D. C. BATES
Secretary.

DEFENDANT'S EXHIBIT No. 1

WESTERN SHORE LUMBER COMPANY

Profit and Loss Statements

	12/31/32	12/31/33	12/31/34	12/31/35	12/31/36
Income					
Timber sales	$22,404.87	29,552.86	26,391.23	30,649.14	9,211.66
Interest		619.57	768.83	300.70	160.61
Tanbark sales			1,455.52		
Old machinery sales				50.00	435.75
Total Income	22,404.87	30,172.43	28,615.58	30,999.84	9,808.02
Less					
Expense	1,044.55	1,153.24	879.00	898.00	1,020.19
Interest (Stockholders)	7,512.61	6,133.56	4,604.75	3,086.50	3,143.77
Taxes property	6,526.91	6,443.73	4,348.36	4,538.54	5,797.09
Trail upkeep	1,500.00	1,500.00	1,500.00	1,500.00	1,325.00
Tallyman	275.00	325.00	275.00	300.00	275.00
Depletion:					
Redwood	7,620.20	8,552.46	8,891.04	10,904.10	4,881.49
Pine		1,512.86	890.38	821.65	1,100.78
Tanbark			912.12		
Total Expenses	24,479.27	25,620.85	22,300.65	22,048.79	17,543.32
Net Income	(2,074.40)	4,551.58	6,314.93	8,951.05	(7,735.30)

[Endorsed]: Filed Feb. 7, 1941.

DEFENDANT'S EXHIBIT No. 2

WESTERN SHORE LUMBER COMPANY

Balance Sheets

	12/31/32	12/31/33	12/31/34	12/31/35	12/31/36
ASSETS					
Cash	36,458.26	44,390.09	41,311.10	33,546.38	31,793.35
Land	66,195.55	66,195.55	66,195.55	66,195.55	66,195.55
Construction Equipment	12,219.98	12,219.98	12,219.98	12,219.98	12,219.98
Roads	1,250.98	1,250.98	1,250.98	1,250.98	1,250.98
Reserve for Depreciation	(12,219.98)	(12,219.98)	(12,219.98)	(12,219.98)	(12,219.98)
Timber	1,540,730.16	1,540,730.16	1,540,730.16	1,540,730.16	1,540,730.16
Reserve for Depletion	(49,317.45)	(65,760.15)	(83,232.18)	(102,394.25)	(108,376.52)
Totals	1,595,317.50	1,586,806.63	1,566,255.61	1,539,328.82	1,531,593.52
LIABILITIES			27,479.08		
Deposit	40,000.00	40,000.00	~~27,749.08~~		
Accts. Payable			1,157.44	195.00	195.00
Loans & Assessments (stockholders)	104,350.75	97,665.68	88,941.70	88,941.70	88,941.70
Capital Stock	1,000,000.00	1,000,000.00	1,000,000.00	1,000,000.00	1,000,000.00
Capital Surplus	628,895.70	622,518.32	615,739.83	608,303.51	608,303.51
Earned Surplus (Deficit)	(177,928.95)	(173,377.37)	(167,062.44)	(158,111.39)	(165,846.69)
	1,595,317.50	1,586,806.63	1,566,255.61	1,539,328.82	1,531,593.52

[Endorsed]: Filed Feb. 7, 1941.

	Wood	Bark Account	Ties and Split Material
190			
190			
190			
191			
191			
191			
191			
191			
191			
191			
191			
191			4,547.63
191			5,090.98
192			(624.45)
192			5,803.84
192			(281.61)
191	1,187.93	1,743.98	
	1,187.93	1,743.98	14,386.39

Rec

n the minutes of a Directors' meeting
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DEFENDANT'S EXHIBIT No. 3

WESTERN SHORE LUMBER COMPANY

Statement Showing a Summary of Sales—Years 1906 to 1922, Inclusive

	DESCRIPTION										
	Total Amount	Property	Stumpage	Machinery	Shakes	Tan Bark	Shingles	Shingle Blocks	Wood	Bark Account	Ties and Split Material
1906 and 1907	None										
1908	$17,711.69		17,211.69	500.00							
1909	None										
1910	38,737.67		7,756.76		4,194.75	26,786.16					
1911	89.15				89.15						
1912	364.00				364.00						
1913	81.50				81.50						
1914	None										
1915	None										
1916	See below										
1917											
1918	4,547.63			150.00							4,547.63
1919	5,090.98										5,090.98
1920	37,775.55	38,400.00									(624.45)
1921	5,803.84										5,803.84
1922	(281.61)										(281.61)
1916 to 1922, Inc.	10,023.29						7,017.53	73.85	1,187.93	1,743.98	
Totals	119,943.69	38,400.00	24,968.45	650.00	4,729.40	26,786.16	7,017.53	73.85	1,187.93	1,743.98	14,386.39

[Printer's Note: Figures in parentheses typed in red in original Exhibit.]

Receipts from option on property:

1922	6,000.00
1923	13,500.00
Total	19,500.00

In 1909 $3,000.00 appears to have been received for the Dougherty Mill & Railroad Extension as referred to in the minutes of a Directors' meeting held on August 16, 1909. This item was closed out in the accounts as an expense item.

[Endorsed]: Filed Feb. 7, 1941.

[Endorsed]: No. 10243. United States Circuit Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. Western Shore Lumber Company, a corporation, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed September 10, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 10243

UNITED STATES OF AMERICA,

Appellant,

vs.

WESTERN SHORE LUMBER COMPANY,

Appellee.

STATEMENT OF THE POINTS TO BE RELIED ON BY APPELLANT

The appellant having taken an appeal to the United States Circuit Court of Appeals for the Ninth Circuit from the judgment rendered by the District Court for the Northern District of California, hereby designates the following points to be relied on in the prosecution of said appeal:

(1) That the District Court erred in rendering judgment for plaintiff in that said judgment is contrary to the facts found by the Court;

(2) That the judgment of the District Court is contrary to law;

(3) That the District Court erred in making, from the facts found, the Conclusions of Law numbered 1, 2 and 3, to-wit:

"1. A corporation such as the plaintiff, which has reduced its activities to the ownership and holding of *of* property, the distribution of its avails, and doing only such acts as are necessary to the maintenance of its corporate existence, and the private management of its purely internal affairs, is not carrying on or doing business within the meaning of Section 215(a) of the National Industrial Recovery Act, Section 710(a) of the Revenue Act of 1934, or Section 105(a) of the Revenue Act of 1935, commonly known as the "capital stock tax law".

"2. The liability of the plaintiff for capital stock taxes must be decided by the purpose for which the corporate organization was maintained, and, where, as in the present case, there was no intent during the taxable period in question or for many years prior to such period to carry on any active enterprise and the sole purpose of the corporation was to hold its timber lands and effect a sale of the whole thereof as soon as a fair price could be obtained, the proceeds to be distributed to stockholders, and there was no purpose or activity

which constituted efforts or the use of capital in the pursuit of gain and profit, the plaintiff was not carrying on or doing business within the terms of said "capital stock tax law".

"3. At no time during the period from July 1, 1932 to June 30, 1936 did the plaintiff carry on or do business in such manner as to subject it to the said capital stock tax. The capital stock taxes paid by the plaintiff in respect of the period from July 1, 1932 to June 30, 1936, were collected from it and retained erroneously and without authority of law and contrary to the laws of the United States relating to Internal Revenue, Plaintiff having taken all proper steps for the refund thereof is entitled to the repayment of the aggregate amount of such taxes, together with interest, as provided by law.

FRANK J. HENNESSY,
United States Attorney.

[Endorsed]: Filed Sep. 10, 1942.

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION FOR PRINTING THE RECORD ON APPEAL

To Paul P. O'Brien, Clerk of the above-entitled Court:

The Appellant designates all of the record as the record to be printed for use in prosecution of the appeal herein, including all exhibits transmitted by order of the District Court to the Clerk of the above-entitled Court.

FRANK J. HENNESSY,
United States Attorney.

[Endorsed]: Filed Sep. 10, 1942.

No. 10,243

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

vs.

WESTERN SHORE LUMBER COMPANY (a corporation),
Appellee.

On Appeal from the District Court of the United States for the Northern District of California.

BRIEF FOR APPELLANT.

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Subject Index

Table of Authorities Cited

Cases

Statutes

Miscellaneous

No. 10,243

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

United States of America,

Appellant,

vs.

Western Shore Lumber Company (a corporation),

Appellee.

On Appeal from the District Court of the United States for the Northern District of California.

BRIEF FOR APPELLANT.

OPINION BELOW.

There has been no previous opinion in this case. The District Court filed findings of fact, conclusions of law and directions for entry of judgment (R. 107-120), which are not reported.

JURISDICTION.

This is an appeal from a judgment entered August 13, 1941, by the District Court, in favor of the appellee for the sum of $2299.00, with interest of $909.52 and costs of $10.00 (R. 121-122). The action arose under the Internal Revenue Laws of the United

States, and is for recovery of capital stock taxes and interest paid for the taxable periods ended each June 30 from 1933 to 1936, inclusive, with legal interest from payment dates. The jurisdiction of the District Court was invoked under the provisions of Section 24, Twentieth, of the Judicial Code, as amended. The case is brought to this Court by notice of appeal filed November 12, 1941 (R. 122). The jurisdiction of this Court is invoked under the provisions of Section 128 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Whether taxpayer corporation was carrying on or doing business during the taxable periods involved within the meaning of the capital stock tax laws.

STATUTES AND REGULATIONS INVOLVED.

Revenue Act of 1935. c. 829, 49 Stat. 1014:

Sec. 105. CAPITAL STOCK TAX.

(a) For each year ending June 30, beginning with the year ending June 30, 1936, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1.40 for each $1,000 of the adjusted declared value of its capital stock. [Amended by Section 601 of the Revenue Act of 1936 to make the rate of the tax $1 for each $1,000.)

*   *   *   *   *   *   *

Treasury Regulations 64 (1936 ed.):

Art. 41. *Nature and rate of tax.*—The tax is an excise tax imposed with respect to carrying on or doing business during a taxable year ending June 30, or any fractional part thereof. It is an excise tax upon the exercise of the privilege of doing business and not on the business itself and is imposed upon each corporation with respect to carrying on or doing business and not upon each business carried on. If more than one corporation is engaged in carrying on a single business, each must file a return and pay the tax. * * *

Art. 42. *Doing business.*—The term "business" is very comprehensive and embraces whatever occupies the time, attention, or labor of men for profit. Accordingly, regardless of the nature of its activities, any corporation organized for profit and carrying out the purpose of its organization is doing business within the meaning of the Act. Similarly, even if not organized for profit, any corporation which nevertheless engages in activities ordinarily carried on for profit is also doing business. It is immaterial whether the activities result in a profit or a loss, whether the corporation has been successful in its enterprise, or that because of unfavorable business conditions, no operations are carried on for a particular period. No particular amount of business need be done, nor is it necessary that the business be continuous throughout the taxable year.

The case is exceptional in which the activities of a corporation organized for profit do not amount to doing business within the meaning of the Act. Such a case is generally limited to one

in which the corporation is not pursuing the ends for which organized, i.e., profit.

Art. 43. *Illustrations.*—(a) *General.*—In general "doing business" includes any activities of a corporation whether it engages in—

(1) buying, selling, manufacturing, developing, financing, speculating or otherwise dealing in property of any description;

(2) furnishing services of any character;

(3) leasing or managing properties, collecting rents or royalties;

*   *   *   *   *   *   *

5.69 this

(5) the orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distributing the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from another corporation, or of the shareholders' fractional interests in particular property; or

(6) any other activities coming within the ordinary and natural signification of the term "carrying on or doing business".

(b) *Exceptions.*—Ordinarily the exceptions to "doing business" are restricted to limited activities of a corporation, such as—

(1) the issuance and sale of its stock for cash as a preliminary step in the completion of its organization; or

1.369 this not the case

(2) the distribution of the avails of property and the doing only of such acts as may be necessary for the maintenance of its corporate status in the case in which the corporation either was

organized for, or has reduced its activities to, the mere owning and holding of specific property.[1]

STATEMENT.

The facts, as found by the District Court, are substantially as follows (R. 107-117):

Western Shore Lumber Company, the taxpayer, was organized in 1905 as a California corporation. Its purpose was to acquire timber lands in San Mateo and Santa Cruz Counties in California. The organizers believed that a railroad was to build a line through the area but the road was never built and the company never engaged in active lumber operations. (R. 107-108.)

In order to pay taxes and current expenses, the company permitted some timber and tanbark to be cut from its land and from that source obtained $36,449.56 between 1905 through 1910. From a similar source the taxpayer obtained $25,094.63 between 1911 and 1922. (R. 108.)

During 1920 some acreage was sold to the State of California for park purposes at a price of $38,400.

[1]The taxes involved in this action are capital stock taxes paid for the taxable periods ended each June 30, 1933 to 1936, and they were collected under the provisions of Section 215 of the National Industrial Recovery Act, c. 90, 48 Stat. 195, for 1933, Section 701 of the Revenue Act of 1934, c. 277, 48 Stat. 680, for 1934 and 1935; and Section 105 of the Revenue Act of 1935, c. 829, 49 Stat. 1014, as amended, for 1936. Each of the taxing statutes and the regulations promulgated thereunder are substantially similar. For that reason extracts from the taxing statute and the regulations under only the 1935 Act are set out above.

During 1918 and 1919 the taxpayer operated a shingle mill but the mill was never operated after 1921. The shingle mill is the only active operation ever carried on by the taxpayer. (R. 108.)

Since the shingle mill was closed the taxpayer's activities have been confined to maintaining and holding its properties until they could be satisfactorily liquidated. The taxpayer paid federal capital stock taxes for the annual periods 1923 through 1926 but filed claims for refund thereof, which were allowed in 1929, on the ground that the company had not engaged in business during those years. (R. 108-109.)

Taxes on the company's properties have been substantial. For a time the taxes were paid out of funds on hand and loans made by stockholders. From 1925 to 1929 assessments were levied against stockholders to pay taxes. In order to provide funds for taxes and current expenses a stumpage contract was entered into with Santa Cruz Lumber Company in 1929, under which that company cut and paid for timber from an isolated portion of the taxpayer's properties. Receipts from the contract have been sufficient to pay taxes and to reduce previously incurred indebtedness to stockholders. The amount of such indebtedness on July 1, 1932, was $66,850.75. (R. 109.)

The period in issue in this action is from July 1, 1932, to June 30, 1936. At the commencement of the period the taxpayer's assets consisted solely of approximately 12,500 acres of timber lands in San Mateo County and 550 acres of timber lands in Santa Cruz County and certain cash in bank accounts. From

July 1, 1932, to June 30, 1936, the taxpayer had no activities except holding and safeguarding the timber properties and occasional negotiations looking toward their disposition as a whole. Little supervision was necessary. The activities carried on by the taxpayer were conducted in the same manner as during the period from 1922 to 1926. During the periods from 1932 through 1936, no meetings of stockholders were held and only three meetings of directors, two during 1933 and one in the 1936 period. At the 1933 directors meetings only routine corporate actions were taken, such as electing officers, employment of auditors, et cetera. The only non-routine corporate action taken at the 1936 meeting was the ratification of a supplemental agreement with Santa Cruz Lumber Company permitting the cutting of timber from certain additional land of the taxpayer under the terms of the existing contract. (R. 109-110.)

Except for the supplemental agreement ratified at the 1936 directors meeting the taxpayer executed no contracts during the period between July 1, 1932, and June 30, 1936. No property except office supplies was purchased. No investments were made. Other than timber no property was sold. The taxpayer's only receipts were interest on bank accounts and the amounts paid under the stumpage contract with Santa Cruz Lumber Company. The taxpayer had no employees except a secretary who was paid $25 per month and a caretaker employed to maintain trails through the timber property and keep a look-out for fires, whose salary was $1800 per year. The tax-

payer's only other disbursements were for taxes, interest on indebtedness, office expenses not in excess of $365 per year, and the amount of $300 per year paid as partial compensation to a man who checked the timber tally made by Santa Cruz Lumber Company under the stumpage contracts. During the taxable periods involved the taxpayer disbursed no dividends nor any other disbursements to its stockholders except payments upon the interest and principal of indebtedness to the stockholders previously incurred. (R. 110-111.)

The taxpayer's timber is mostly redwood. It is the only large holding of redwood timber left in the vicinity and some negotiations have been had toward the sale of the timber to the State for park purposes. The taxpayer has been unwilling to sell the timber or lands piece-meal but has made efforts to sell the properties as a whole and has given options to prospective purchasers on several occasions although no such option was given during the periods from 1932 through 1936. (R. 111-112.)

The taxpayer's directors have given considerable thought as to a means of liquidating the property but could arrive at none except through a sale to the County of San Mateo or the State of California or by a program of logging contracts, which the taxpayer did not care to undertake. Under the stumpage contracts entered into the property is completely deforested and rendered almost valueless. The contracts with Santa Cruz Lumber Company covered 1500 or 1600 acres, which are in an isolated section, and their

deforestation does not affect the value of the remaining properties as a park site. The area which has been cut over, in the opinion of the president of the company, is worth only fifty cents an acre after deforestation. (R. 112.)

The receipt of income under the stumpage contracts constitutes the only difference between the activities of the taxpayer during the periods here involved and its activities during the period from 1922 through 1926, when the taxpayer was held not to have engaged in business for federal capital stock tax purposes. (R. 112-113.)

The timber stumpage contracts were made to obtain funds to pay taxes and current expenses. The first contract was executed on April 23, 1929, and related to 480 acres of land. Santa Cruz Lumber Company was given the right to remove from the land all redwood timber, pine timber and tanbark. It agreed to pay $4 per thousand feet, board measure, for redwood and pine and $5 per cord for tanbark, with a minimum guaranteed payment of $10,000. The board measure of the timber cut was made by a tally at the tail end of the mill of the operating company. The tally was made by a man selected by the parties, whose expenses were borne equally by the parties. The operating company was required to proceed continuously with the removal of timber and tanbark and the taxpayer had the right to inspect the operations of Santa Cruz Lumber Company and its books and records for the purpose of ascertaining that all provisions of the contract were complied with. The first

contract was to expire in two years. A second contract was entered into by the same parties on March 10, 1930 and contained terms similar to those in the first contract. The second contract was to run for a period of eight years. A third contract was entered into on January 17, 1936 by the same parties, relating to the same 480 acres covered by the first contract, and provided that such acreage should be deemed to be covered by the contract of March 10, 1930. (R. 113-114.)

The taxpayer's activities in connection with the timber stumpage contracts were limited to the receipt of money thereunder, except that it paid the tally man $300 per annum to verify the tally made by the operating company upon the basis of which payments were made. Payments for timber and tanbark were required to be made monthly and the taxpayer received on that account the following sums: (R. 114.):

Year ending June 30	Amount received
1933	$21,206.70
1934	32,372.78
1935	4,625.93
1936	9,404.54

After payment of taxes, current expenses and interest, and after setting aside a reserve for taxes, the balance of the moneys received were used toward retirement of the indebtedness to stockholders. During the taxable periods involved in this action $13,821.89 was paid on the indebtedness and subsequently the whole indebtedness was paid off out of timber stumpage receipts. (R. 115.)

For income tax purposes the taxpayer had a profit during the taxable periods involved aggregating $10,-007.86, but its total deficit at December 31, 1936 was $165,846.69. (R. 115.)

The taxpayer engaged in no operations under the stumpage contracts. The contracts were in substance a license to an operating company to cut timber from an isolated tract of the taxpayer's properties and to pay for the timber as cut. The cut-over land was rendered substantially valueless and the operation amounted in essence to a liquidation of the property from which the timber was cut. (R. 115.)

With the exception of the supplemental agreement dated January 17, 1936, the stumpage contracts were not negotiated during the taxable periods involved in this action. (R. 115.)

The taxpayer filed timely capital stock tax returns for each of the taxable periods 1933 to 1936, inclusive, and paid the amounts of taxes indicated thereon. Timely claims for refund were filed for each of the payments made for the periods mentioned, on the ground that the corporation had not engaged in business and was not liable for the capital stock tax during any of the periods. (R. 116.)

The Commissioner of Internal Revenue rejected each of the claims for refund and notified the taxpayer of his action by letter dated January 26, 1938. This action was then timely commenced by filing the complaint herein on November 30, 1939. The action is based on the same grounds as set forth in the claims for refund. (R. 116-117.)

Upon the basis of the foregoing findings of fact, the Court below concluded as matters of law that (R. 117-118):

The taxpayer has reduced its activities to ownership and holding of property, the distribution of its avails, and doing only necessary acts to maintain its corporate existence and the management of its internal affairs and is not doing business within the meaning of the capital stock tax laws. (R. 117.)

The liability for the capital stock tax must be determined by the purpose for which the corporate organization was maintained and where, as in the present case, there was no intent during the taxable period and for many years prior thereto to carry on any active enterprise and the sole purpose of the corporation was to hold its timber lands and effect a sale of the whole as soon as a fair price could be obtained, the proceeds to be distributed to stockholders, and there was no purpose or activity which constituted efforts or the use of capital in the pursuit of gain and profit; the taxpayer was not doing business. (R. 117-118.)

The taxes involved were erroneously and illegally collected and the taxpayer is entitled to a refund thereof with legal interest. (R. 118.)

STATEMENT OF POINTS TO BE URGED.

The government relies on all the points specified. (R. 227-229.) In substance they are that the judgment of the District Court is contrary to law; that the

judgment is contrary to the facts found by the Court and that the facts found do not support the conclusions of law rendered by the Court.

SUMMARY OF ARGUMENT.

Any doubts that the taxpayer was doing business so as to be liable for the capital stock tax have been resolved by the Supreme Court decision in *Magruder v. Washington, B. & A. Realty Corp.* In that case a corporation organized to liquidate properties, and doing so, was held to be doing business as falling within the provisions of the regulations of long standing. The regulation was held to be valid as well as applicable. The same regulation is applicable here.

This taxpayer's activities were directed toward liquidating its properties as satisfactory offers were obtained, as were the activities of the taxpayer in the Supreme Court case. Differences in the purposes for organization of the corporations are not controlling where the activities are of a business nature. The extent of the activities is not material if any business is carried on. Performing engagements entered into in a prior year is nonetheless doing business during the taxable year.

ARGUMENT.

THE TAXPAYER WAS DOING BUSINESS DURING THE TAXABLE PERIODS INVOLVED AND IS SUBJECT TO THE CAPITAL STOCK TAX.

Doubts as to whether this taxpayer's activities during the taxable periods involved constitute doing business within the meaning of the capital stock tax laws would seem to have been resolved in favor of the government by the recent decision in the case of *Magruder v. Washington B. & A. Realty Corp.*, 316 U. S. 69, decided April 13, 1942. In that case a corporation was organized for the purpose of liquidating the properties of another corporation, and since its organization carried on negotiations for the sale of properties, selling them from time to time as satisfactory offers were received, and renting unsold properties under short term leases in an attempt to earn the carrying charges pending ultimate sales of all of the properties. The corporation was held to be doing business for the purpose of the tax. The case turned upon the question whether Article 43 (a) (5) of Treasury Regulations 64 (1936 ed.) was both applicable and valid. The Article mentioned is also one of the articles of the regulations upon which the government relies in the present case. The Supreme Court held at pages 72-74:

> The regulation, Article 43 (a) (5), provides:
>
> "Art. 43. *Illustrations.—General.*—In general 'doing business' includes any activities of a corporation whether engaged in——
>
> *　　*　　*　　*　　*　　*
>
> "(5) the orderly liquidation of property by negotiating sales from time to time as opportunity

and judgment dictate and distributing the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from another corporation, or of the shareholders' fractional interests in particular property;"

If the regulation is both applicable and valid, respondent manifestly cannot prevail.

On the question of applicability there can be no doubt, for the language of the regulation precisely describes respondent's activities. We find without substance respondent's assertions that Article 43 (b) (2) is inconsistent with Article 43 (a) (5) and that it more exactly fits the facts of this case. During the period in question, respondent did not fall into that state of quietude, covered by the specific language of Article 43 (b) (2), in which it was merely owning and holding specific property and distributing the resulting proceeds. See *Zonne v. Minneapolis Syndicate,* 220 U. S. 187; cf. *Von Baumbach v. Sargent Land Co.,* 242 U. S. 503, 516-17. On the contrary, respondent was actively engaged in fulfilling the purpose of its creation, the liquidation of its holdings for the best obtainable price.

Article 43 (a) (5) is both a contemporary and a long standing administrative interpretation, having been in effect in substantially the same form since 1918, except for the period from 1926 to 1933 when the tax was not imposed. We are of opinion that it is valid, as well as applicable. The crucial words of the statute, "carrying on or doing business," are not so easy of application to varying facts that they leave no room for administrative interpretation or elucidation. To be sure, in many, if not in most instances, the factual situ-

ation will be so extreme as to leave no doubt whether a corporation is doing business or not. But the nuances of facts between the two extremes have produced a nebulous field of confusion which has been recognized by courts striving to fit close cases into one category or the other. Interpretative regulations, such as Article 43(a)(5), are appropriate aids toward eliminating that confusion and uncertainty. Cf. *Helvering v. Wilshire Oil Co.,* 308 U. S. 90, 102; *Textile Mills Securities Corp. v. Commissioner,* 314 U. S. 326.

Factually the present case is not on all-fours with the *Washington B. & A. Corp.* case, *supra,* but the differences, we believe, are not such as to cause a contrary decision of the ultimate question. The corporation involved in the Supreme Court case was organized to liquidate properties, whereas the present taxpayer was organized as a logging and lumber company but during the taxable periods had reduced its activities to efforts looking toward liquidating all of the corporation's properties when satisfactory offers were obtained. We find no indication in the Supreme Court decision that corporations carrying on activities looking toward liquidation should be distinguished, so as to hold one organized for the purpose of liquidating properties to be doing business and another organized originally as an operating company not to be doing business. In either event the *activities* are similar and we submit that if such activities constitute doing business in one case they do in both cases. In the present case there can be no question but that the activities of the corporation were directed toward liquidating its properties. The District Court correctly

and specifically so found. (R. 109, 112, 115.) The District Court said (R. 115):

> * * * The land from which the timber was cut was rendered substantially valueless and the operation amounted in essence to a liquidation of the property from which the timber was cut.

If there were doubt or conflict in the decisions at that time the subsequent decision of the Supreme Court, we submit, requires the holding that the acts of liquidating and the activities of the taxpayer in connection therewith constituted doing business.

It may be urged that the *Washington, B. & A. Realty Corp.* carried on a more concerted or more continuous program of liquidation than this taxpayer did or that the activities were more closely confined to the taxable periods involved. However, neither consideration should make the cases distinguishable. If it be the fact that the *Washington, B. & A. Realty Corp.* was more active than the present taxpayer it is only a matter of degree and it has been frequently held that the statute "requires no particular amount of business in order to bring a company within its terms." *Von Baumbach v. Sargent Land Co.*, 242 U. S. 503, 517; *Page v. M. Rich & Bros. Co.*, 99 F. 2d, 607; *Argonaut Consolidated Mining Co. v. Anderson*, 52 F. 2d 55 (C. C. A. 2), certiorari denied, 284 U. S. 682; *American Investment Securities Co. v. United States*, 112 F. 2d 231 (C. C. A. 1). In the cases cited the quantity of business carried on by the corporations involved was not substantial, and was fairly comparable to the activities of the taxpayer

here. Thus, in the *Von Baumbach* case the corporation had leased its mineral lands on a royalty basis, received the rentals, employed another company to inspect the properties for it, and sold and rented certain minor portions of its other real estate. It would seem that if leasing ore lands on a royalty basis, with the right of inspection reserved as in the *Sargent Land Co.* case, *supra,* is doing business, then selling timber stumpage, with the right of inspection and checking reserved as in this case, must also be doing business.

The fact that two of the taxpayer's stumpage contracts were entered into prior to the taxable periods and only one contract ratified within a taxable period is not important. In the recent case of *Barker Bros. Corporation v. Rogan,* 126 F. 2d 917 (C. C. A. 9th) this Court referred to the well established principle that the fact that transactions by the taxpayer during the taxable period performed engagements made in a prior year made the performance none the less business done in the taxable year. The operations under the stumpage contracts were continuous throughout the taxable periods and subsequently. Receipts from the contracts were substantial ranging from \$4625.93 in 1935 to \$32,372.78 in 1934 (R. 114), and in later years an indebtedness of \$165,846.69 was paid out of timber receipts. (R. 115.)

Viewed as a whole, it is submitted that the taxpayer's situation and activities constituted doing business within the meaning of the applicable statutes and regulations and the controlling authorities.

CONCLUSION.

The decision of the District Court is in error and should be reversed.

Dated, November 13, 1942.

Respectfully submitted,

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No. 10,243

United States Circuit Court of Appeals

For the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

vs.

WESTERN SHORE LUMBER COMPANY (a corporation),
Appellee.

On Appeal from the District Court of the United States for the Northern District of California

BRIEF FOR APPELLEE

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Table of Contents

Table of Authorities Cited

Cases

REGULATIONS

No. 10,243

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Appellee.

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BRIEF FOR APPELLEE

INTRODUCTORY.

We take no exception to the statements in the Brief for Appellant as to ''Opinion Below'', ''Jurisdiction'', ''Question Presented'' and ''Statutes and Regulations Involved''

Following the style of appellant's brief, we shall refer to the appellee herein as ''the taxpayer''. We shall use the term ''the taxable years'' to mean the years taxable for

the purpose of the capital stock taxes involved in this case, namely, the four separate years ending each June 30th during the period from July 1, 1932 to June 30, 1936, both inclusive.

As indicated by the Brief for Appellant, there is no procedural or jurisdictional question in this appeal and no dispute as to the amount of taxes involved. The sole question is as to the merits, namely, whether the taxpayer was doing business during the taxable years within the meaning of the capital stock tax law.

The Statement of Facts in the Brief for Appellant is correct as far as it goes, but it is very limited in its portrayal of the important elements of fact. It is a mere re-statement, almost verbatim, of the findings. While the findings (R. 107-117) are entirely sufficient as such, they are hardly adequate to present a full and balanced picture of the taxpayer's activities during the taxable years. To rely wholly on the findings as a statement of facts for the purposes of this appeal leaves unmentioned so many important and descriptive features of the evidence and ignores so completely the relative importance of certain facts that we propose to re-state the important facts, referring also to the supporting details in their appropriate relationship.

THE IMPORTANT FACTS.

1. The taxpayer was organized for the purpose of conducting an active lumber business, but was frustrated in this purpose and never conducted any active lumber business except for a partial operation which was terminated more than ten years before the taxable years.

The taxpayer was incorporated in 1905 because it was believed by its incorporators, including Timothy Hopkins, then treasurer of the Southern Pacific Railroad Company, Senator Felton, and others, that the railroad company was going to build a branch line from San Francisco to Santa Cruz which would go through certain timberlands in Southern San Mateo County and Northern Santa Cruz County (R. 107-108; see also testimony of witness Wood, President of the taxpayer, R. 158-159). Thus the taxpayer was incorporated to acquire these timberlands (R. 107-108) and to operate an active lumber business thereon (R. 158, 160; and see Articles of Incorporation, statement of purposes, R. 100). Although the lands were purchased and thereafter constituted the principal asset of the taxpayer (R. 108, 109-110, 145, 160), the railroad line was never constructed (R. 108, 158-159), so that the taxpayer's primary purpose of conducting a lumber business in all its branches (Articles, R. 100) was completely frustrated. As a result the taxpayer never engaged in any active lumber operation with the sole exception that it operated a small shingle mill commencing about 1918-1919, "but the mill was shut down and was never operated after 1921" (R. 108).

Another party operated a small lumber business on the taxpayer's lands at various times, including the taxable

years, under circumstances which will be further explained below, but the taxpayer itself never engaged in the business for which it was primarily incorporated after the year 1921 (R. 108).

2. For many years prior to and including the taxable years the taxpayer's primary function and activity was that of holding its property until it could be sold as a whole.

Having thus been frustrated in its original purpose of engaging actively in the lumber business, the taxpayer's primary function became—at least by the end of 1921, when the shingle mill was shut down—and thereafter remained, that of owning and holding its timberlands, and it thereafter confined its activities to the maintaining and holding of these timberlands until they could be satisfactorily liquidated (R. 108-109; see also R. 135). But even after this change from its original purpose had become clear, it did not engage in any campaign to sell or otherwise liquidate its properties (R. 112). On the contrary, the record shows that its efforts to sell were conditioned by the hope that it would be able to sell its properties as a whole (R. 111-2). Both before and during the taxable years it had negotiations looking toward a sale of the property as a whole—especially negotiations for such a sale to the State of California or County of San Mateo (R. 111-112, 157-158, 186). On several occasions the taxpayer gave options to prospective purchasers, although no such options were given during the taxable years (R. 112). Such options were in the form of options for sale of the properties as a whole (R. 179-180, 186). At all times the taxpayer was unwilling to sell the property piecemeal (R. 112, 134, 137).

In other words, beginning at least as early as 1922 and from then on, the taxpayer was primarily engaged in merely holding and carrying its timberlands pending the sale of such lands as a unit—a sale which was expected at some indefinite time in the future when a satisfactory deal might be available.

3. The taxpayer was not organized as a liquidating company, never acted as a company primarily engaged in liquidation, but, on the contrary, the taxpayer's only liquidation activities—especially during the taxable years—were necessary for and incidental to the holding of its properties.

Examination of the taxpayer's Articles of Incorporation shows that it was not organized for the purpose of liquidating properties which were already owned by its incorporators, but rather "to engage in and carry on in all their branches a general lumber, * * * manufacturing * * * [etc.] business" and to acquire the necessary lands and other properties therefor (R. 100). This purpose is also shown by the finding that the taxpayer was organized to acquire the timberlands because of the proposed construction of the railroad branch (R. 107-108) and the evidence that these properties were acquired after the taxpayer's organization pursuant to such purpose and as a venture in the lumber business (R. 145, 158, 160). There is nothing in the Articles of Incorporation indicating any intention to act as a liquidating company and the word "liquidate" or "liquidation" does not appear in the statement of purposes in those Articles (R. 100-102). The directors of the corporation had never even discussed dissolution (R. 141-142), nor had they ever adopted a resolution directing liquidation (R. 152).

The yearly taxes on the taxpayer's timber lands have been quite substantial (R. 109). There were also minor current expenses. For example, during the taxable years there were such items as the salary of a caretaker to watch for fires and build fire-trails, the secretary's salary and other miscellaneous expenses (R. 111, 140-141, 162-165, 185). Prior to 1932 the taxpayer had practically no income (R. 135). Sales of timber and tanbark up to and including 1910 had raised $36,449.56 (R. 108) and during the years 1911 to 1922 the taxpayer received $25,094.63 from a similar source (R. 108). In 1920 it sold a portion of its acreage to the State of California for park purposes for $38,400 (R. 108). (These amounts are comparatively small in view of the total property values shown on the balance sheets (R. 225) and the total values reflected by option rights (R. 179-180), indicating total values in excess of one million dollars.) These sums, constituting funds on hand, and other moneys obtained by loans from stockholders, were used to pay the taxes and expenses (R. 109). But during the period from 1925 to 1929 moneys to pay the taxes had to be and were raised by assessments levied on the stockholders (R. 109).

As of July 1, 1932, the indebtedness to stockholders was $66,850.75 (R. 109) and on December 31, 1932, six months after the beginning of the first taxable year, loans and assessments by stockholders, as shown by the taxpayer's balance sheet, amounted to $104,350.75 (R. 225).

Commencing in 1929, in order to provide funds to pay taxes and current expenses (R. 109), the taxpayer entered into certain "stumpage contracts" with the Santa Cruz Lumber Company, a corporation with which it had no

affiliation (R. 113-114, 140). These contracts were three in number. The first one, dated April 23, 1929, covered 480 acres (R. 44-45, 113), but all rights under it expired two years from its date (R. 47, 113), so that it was not actually in effect during the taxable years except as the same property was covered by the third agreement described below. The second stumpage agreement was dated March 10, 1930, and covered an additional 1360 acres and, as it was performed by the parties, continued for a term of eight years from its date (R. 114, 196-197; and see R. 224 and R. 114-115). The third stumpage contract was dated January 17, 1936, and was merely a supplemental agreement whereby the 480 acres originally covered by the first contract, dated April 23, 1929, were subjected to the terms of the second contract dated March 10, 1930, with certain changes not important in the present connection (R. 114, 205-208). This contract was evidently made for the reason that all of the timber and tanbark on those 480 acres had not been cut or removed during the original two-year term of the 1929 agreement.

In effect, therefore, the three stumpage contracts merely constituted a single arrangement whereby Santa Cruz Lumber Company was given the right to cut timber and remove tanbark from a total of 1840 acres out of more than 13,000 acres owned by the taxpayer (R. 113-114; see also the agreements in the record at the pages referred to above and compare the total acreage at R. 109). Santa Cruz Lumber Company had the right to cut over these acres during the years 1929 to 1938, inclusive, and was given possession of the land for that purpose, subject, of course, to certain covenants contained in the contracts as

to due diligence and the payment to the taxpayer of the stumpage amounts specified in the contracts, namely, from $2 to $4 per thousand feet of redwood and pine timber and $5 per cord of tanbark (R. 113-114; and see the contracts in the Record, especially R. 46, 193-194 and 207-208). The total of 1840 acres to which these contracts applied constituted an isolated portion of the taxpayer's lands located on a steep hillside entirely separated from its main block of timberlands by other lands—in different ownership—and of such a character that the lumbering operations on such 1840 acres did not affect the value of the main block of timberlands (R. 112, 137-138 and 156-157). Thus in effect these contracts, taken together, constituted a single continuous arrangement made before the first taxable year, although supplemented in the last taxable year (ending June 30, 1936) by the consolidation of the two separate parcels under a single contract. Furthermore, this entire arrangement constituted in substance a sale by the taxpayer made before the first taxable year of certain timber on an isolated part of its lands, pursuant to which sale some of the timber might be, and was, taken off during the taxable years.

The sole purpose of these stumpage contracts, as well as the sales of timber and tanbark and of redwood lands up to 1922, was to enable the taxpayer to carry and hold its main block of timber lands. The District Court expressly found that the purpose of the stumpage arrangement was to provide the taxpayer with funds to pay taxes and current expenses (R. 113). The deforestation of the lands from which the timber was cut under the stumpage contracts rendered these lands almost valueless (R. 112)

and amounted in essence to a liquidation of the property from which the timber was cut (R. 115). But this was an incidental effect of the stumpage contracts. The proceeds of the stumpage arrangement, including both timber and tanbark proceeds, constituted the only gross receipts of the taxpayer during the taxable years except for minor amounts of interest on bank deposits and less than $500 from sales of machinery from the shut-down shingle mill (R. 224; see also 163-164, 176, and 180-181). All these proceeds were used either directly to pay carrying charges such as taxes and current expenses or as a reserve for future carrying charges, or else were applied as partial payments to the stockholders upon loans which had previously been made by them for earlier carrying charges (R. 114-115). In this connection it appears from the record that loans and assessments by stockholders which, as above stated, amounted to $104,350.75 on December 31, 1932, six months after the beginning of the first taxable year, had only been reduced to $88,941.70 on December 31, 1936, six months after the close of the last taxable year (R. 225). Thus the taxpayer did not during the taxable years succeed in paying off much of the previously incurred carrying charges (see also R. 115 where it is found that the reduction in debt during the taxable years was $13,821.89).

Finally, it is important that under the stumpage arrangement with Santa Cruz Lumber Company the active lumbering business—the cutting of timber and manufacturing of lumber—was conducted, *not* by the taxpayer, but by Santa Cruz Lumber Company. "The timber stumpage contracts did not contemplate that the Company [tax-

payer] itself would engage in any operations, and the Company did not in fact do so. The contracts were in substance simply a license to an operating timber company to cut timber from an isolated section of the Company's properties under an agreement to pay for the timber so cut. * * *" (R. 115; see also R. 148-149). Except for incidental rights, such as rights of inspection, to ascertain that the contracts were properly performed, the arrangement gave to the taxpayer only the right to receive payments in proportion to the timber and tanbark cut by Santa Cruz Lumber Company at the rates above mentioned (R. 44-51, 189-202 and 205-208). The taxpayer maintained a talleyman whom it paid $300 per year to check the count of timber at the mill of Santa Cruz Lumber Company, but this was merely to insure full and correct payments (R. 111, 113-114, 140, 155, 195-196). Thus all that the taxpayer did under these contracts was to receive funds and protect its rights to receive them. (See also R. 114-115.)

4. All other activities of the taxpayer during the taxable years were solely necessary for, or incidental to, the preservation of its corporate existence in good standing and the carrying of its properties.

Except as stated above in this brief, the only activities of the taxpayer during the taxable years consisted of the following:

> The employment of a secretary at $25 per month to keep the taxpayer's books and records (R. 111, 141);
>
> The employment of a caretaker at a cost of $1800 per annum to maintain fire trails in its timberlands and to protect its properties against fires (R. 111, 140-141, 185);

The holding of three meetings of its Board of Directors devoted to routine matters, such as election of officers, banking and safe deposit box resolutions, employment of auditors, other minor matters necessary to keep it in good standing and the acknowledgment of its debts to stockholders in order to keep such debts from being barred by the statute of limitations (R. 110; see also the minutes, R. 43, 58-76, 83, 89-95);

The payment of office expenses and purchase of office supplies (R. 110-111).

During this period the taxpayer executed no contracts except the supplemental agreement with Santa Cruz Lumber Company, dated January 17, 1936, which in effect merely consolidated with the properties under the 1930 agreement the 480 acres originally covered by the 1929 agreement (see above, page 7; R. 110); nor did it purchase any property except office supplies, make any investments, sell any properties or carry on business activities for a profit (R. 110).

To summarize: Long before the commencement of the first taxable year, the taxpayer had abandoned all hope or intention of engaging in the lumber business or any other activity for the pursuit of profit or gain and had determined merely to hold its timberlands until they could be sold as a whole. This intention persisted throughout the taxable years, during which some negotiations to effect such a sale were conducted without success. All of the other activities of the taxpayer during the taxable years were solely such as were necessary for or incidental to the preservation of its existence and the carrying of

its principal timberlands. That the taxpayer had fallen into the state of quietude of a corporation merely holding its property and maintaining its existence is further substantiated by examination of its receipts and disbursements and also its balance sheets for the period 1932-1936, which includes the taxable years. (See R. 224-5.)

SUMMARY OF ARGUMENT.

Before and during the taxable years the taxpayer had reduced its activity to the mere owning and holding of its timberlands, the distribution of the avails thereof and the doing only of such acts as were necessary for the maintenance of its corporate status and the preservation of its main block of timberlands. The stumpage contracts involved no operations by the taxpayer, and the receipt of stumpage payments thereunder amounted to no more than receiving certain ordinary fruits of the ownership of standing timber. The stumpage contracts were entered into in aid of the taxpayer's major purpose and activity, namely, the holding of its timberlands and the maintenance of its corporate status, and were purely incidental thereto. The taxpayer was not organized as a liquidating corporation nor was it actively engaged in liquidating and *Magruder v. Washington, Baltimore & Annapolis Realty Corp.*, 316 U.S. 69, is not in point. Under appellant's regulations a corporation engaged principally in holding its properties was not classified as doing business or subject to the capital stock tax. Appellant's contentions in this case are therefore without support in fact or in law.

ARGUMENT.

1. To be carrying on or doing business within the meaning of the capital stock tax law, a corporation must be organized or its existence maintained for the purpose of engaging in activities for the pursuit of profit or gain.

Decisions of the United States Supreme Court have established the basic principles. Naturally, a corporation organized for profit and pursuing the purpose for which it was organized is doing business.

Thus, corporations whose businesses were principally the holding and management of real estate were held to be doing business in

Flint v. Stone Tracy Co. (1911) 220 U.S. 107, 169.

So, corporations organized to unite undivided fractional interests in timber and mineral lands, empowered to explore, develop and otherwise deal therein, and actually engaged in such activities by disposing of parts thereof, selling stumpage, renting parcels, making explorations and employing an agent to supervise and inspect work, were held to be doing business in

Von Baumbach v. Sargent Land Co. (1917) 242 U.S. 503.

A holding company organized to provide financing for its subsidiary and engaged in so doing and in controlling its subsidiary's business and activities, was held to be doing business in

Edwards v. Chile Copper Co. (1926) 270 U.S. 452.

So, also, was a holding company whose activities included buying and owning the securities of its subsidiaries, en-

dorsing the notes of one, and purchasing bonds of a subsidiary for retirement or sinking fund purposes.

> *Phillips v. International Salt Co.* (1927) 274 U.S. 718; reversing *International Salt Co. v. Phillips* (C.C.A. 3rd, 1925) 9 Fed.(2d) 389.

A corporation which was organized by the bondholders' committee of a defunct railroad corporation to acquire and liquidate properties obtained from the railroad corporation through foreclosure, and which was actually engaged in such activities, was held to be doing business in

> *Magruder v. Washington, Baltimore & Annapolis Realty Corp.* (1942) 316 U.S. 69.

On the other hand, if the characteristic function of the corporation and the one it is carrying out is not the pursuit of gain or profit, the corporation is not doing business. Thus, in

> *United States v. Emery, Bird, Thayer Realty Company* (1915) 237 U.S. 28,

the corporation was organized by members of a Dry Goods Company for the purpose of acquiring the Dry Goods Company's lands and letting them to it, the latter having the management of the property, and assuming the responsibilities in respect of it. The corporation was empowered to perform and enforce the lease and to sell the property upon vote of its stockholders. It covenanted to re-build in case the building were destroyed. The only business it had was to keep up its corporate organization and collect and distribute the rental from its lessee. The court held the corporation was not doing business, saying (p. 32):

"The question is rather what the corporation is doing than what it could do, 228 U.S. 305, 306, but looking even to its powers they are limited very nearly to the necessary incidents of holding a specific tract of land. The possible sale of the whole would be merely the winding up of the corporation. That of a part would signify that the Dry Goods Company did not need it. The claimants' characteristic charter function and the only one that it was carrying on was the bare receipt and distribution to its stockholders of rent from a specified parcel of land. Unless its bare existence as an intermediary was doing business, it is hard to imagine how it could be less engaged."

Even though a corporation is originally organized for profit, if it subsequently discontinues such activities and thereafter merely maintains its corporate existence and organization, holds its property and receives and distributes the avails thereof, it is not then carrying on or doing business within the meaning of the act, whether or not it also limits its corporate powers. In

Zonne v. Minneapolis Syndicate (1911) 220 U.S. 187,

the corporation was originally organized for the purpose of letting stores and offices in a building owned by it. After carrying on that business, it later leased all its property for a term of 130 years, amending its articles of incorporation to limit its purposes solely to holding the title subject to the lease, and to receiving and distributing to its stockholders the rentals accruing therefrom and the proceeds accruing from any distribution of

the land. It was held not doing business. The court said (p. 191):

> "It had wholly parted with control and management of the property; its sole authority was to hold the title subject to the lease for 130 years, to receive and distribute the rentals which might accrue under the terms of the lease, or the proceeds of any sale of land if it should be sold. The corporation had practically gone out of business in connection with the property and had disqualified itself by the terms of reorganization from any activity in respect to it."

McCoach v. Minehill Ry. Co. (1913) 228 U.S. 295,

dealt with a corporation which for many years had operated a railroad. Subsequently it leased its entire properties and franchises to the Reading Company, pursuant to legislative authority, for a long term at a yearly rental and thereafter merely maintained its corporate existence and organization, received annually the fixed rental, interest on bank deposits and interest on dividends and on a "contingent fund" maintained by it, paid office expenses, kept stock books, and its stock was bought and sold on the market. It did not, however, exercise the power of eminent domain or any other special corporate powers. Holding the company not to be doing business, the court said (pp. 303-304):

> "From the facts as stated above it is entirely clear that the Minehill Company was not, during the years of 1909 and 1910, engaged at all in the business of maintaining or operating a railroad, which was the prime object of its incorporation. This business, by the lease of 1896, it had turned over to the Reading

> Company. * * * And it is the Reading Company, and not the Minehill Company, that is 'doing business' as a railroad company upon the lines covered by the lease and is taxable because of it."

Such a quiescent corporation is not doing business merely because it applies the property it holds in such a manner as to produce an income which it distributes to its stockholders.

In *McCoach v. Minehill Ry. Co.*, above, the court gave consideration to the fact that the Minehill Company had a considerable amount of personal assets, known as its "contingent fund", in the form of investments from which it derived an annual income of about $24,000; that it kept a bank deposit, received and collected interest upon such deposit and distributed the income thus received, as well as the rentals, after payment of expenses and taxes, to its stockholders as dividends. The court declared, as to this (p. 306):

> "In our opinion the mere receipt of income from the property leased (the property being used in business by the lessee and not by the lessor) and the receipt of interest and dividends from invested funds, bank balances, and the like, and the distribution thereof among the stockholders of the Minehill Company, amount to no more than receiving the ordinary fruits that arise from the ownership of property."

2. In determining whether or not a corporation is doing business, its actual activities must be considered in relation to the purpose for which it was organized or is being maintained; the bare activities alone are not necessarily determinative.

The foregoing cases provide the principal guideposts to the question of what constitutes doing business within the meaning of the capital stock tax law. However, no formula as to what constitutes doing business has been deduced to fit all situations, as this Court pointed out in

> *United States v. Hercules Mining Co.* (C.C.A. 9th, 1941) 119 Fed.(2d) 288 (291),

and no such formula will be attempted here. There is, nevertheless, one feature of all the foregoing cases which is especially significant for present purposes. That is the emphasis given by the court to the purpose for which the corporation was organized in its relation to the corporation's actual activities. The solution of each case seemed to turn on that point. Using language taken from some of these opinions, the critical question in each case may be stated as follows:

> Was the corporation "organized for the purpose of doing business and actually engaged in such activities . . ."? (*Flint v. Stone Tracy Co.*, 220 U.S. at page 171.)
>
> Was the corporation "engaged in the business . . . which was the prime object of its incorporation"? (*McCoach v. Minehill Ry. Co.*, 228 U. S. at pages 303-304.)
>
> Was the corporation "carrying on" its "characteristic charter function"? (*United States v. Emery, Bird, Thayer Realty Co.*, 237 U.S. at page 32.)

Was the corporation "maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes"? (*Von Baumbach v. Sargent Land Co.*, 242 U.S. at page 516.)

Was the corporation "organized for profit and . . doing what it principally was organized to do in order to realize profit"? (*Edwards v. Chile Copper Co.*, 270 U.S. at page 455.)

Was the corporation "actively engaged in fulfilling the purpose of its creation"? (*Magruder v. Washington, Baltimore, Annapolis Realty Corp.*, 316 U.S. at page 73.)

It is thus very evident that whether or not the corporation's actual activities are those for which it was primarily incorporated is of vital importance in determining whether or not it is carrying on or doing business.

Appellant's position, however, is that "differences in the purposes for organization of the corporations are not controlling where the activities are of a business nature" (Br. p. 13). Appellant's argument is predicated squarely upon this proposition. The effect of appellant's entire argument is this: That the taxpayer's activities here have been reduced to acts of liquidating; that it is immaterial whether or not such was the purpose of organizing the corporation, and that since a corporation organized for the purpose of liquidating and actually fulfilling that purpose was held to be doing business in *Magruder v. Washington, Baltimore & Annapolis Realty Co.*, above, this case is controlled by that decision.

We cannot agree with appellant that the taxpayer's activities may fairly be described as reduced to efforts looking toward liquidation, as we will show below. Even apart from that, however, the significance of the purpose of incorporation is a fundamental point of difference between us and one which can best be clarified by answer to appellant's argument now.

3. The taxpayer's major purpose and activity during the taxable years was holding its property, and it may not fairly be said to have "reduced its activities to efforts looking toward liquidating . . .", as appellant states.

Appellant states, on page 13 of its brief, "This taxpayer's activities were directed toward liquidating its properties as satisfactory offers were obtained * * *"; and, on page 16, that the taxpayer "had reduced its activities to efforts looking toward liquidating all of the corporation's properties when satisfactory offers were obtained * * *". Similar statements are found elsewhere on page 16 and on page 17 of the brief.

We do not believe such statements are quite justified either by the record or by the findings. It is true that the taxpayer has long intended to make a sale of its properties as a whole, if and when a satisfactory price is obtainable, but the same thing is true of many mere holding companies. It is also correct that in years past options to sell as a whole have been made, but never exercised, that efforts have been made for many years to negotiate a sale of the property as a whole to the County of San Mateo or the State of California, and that the taxpayer has been and is holding its property and maintaining its

organization until such a sale can be effected. But taxpayer has never been willing to liquidate piecemeal or by a campaign of sales, and it gives the facts a false emphasis to say, as appellant does, that its activities were "reduced to efforts looking toward liquidating".

The major activities of the taxpayer consisted of preserving its properties and maintaining its organization, paying taxes and expenses and raising money for that purpose. Even the stumpage contracts, which rendered almost valueless the small portion of the taxpayer's holdings affected and thus resulted in a practical liquidation to that small extent, were not primarily for liquidation. They were entered into to provide funds for taxes and expenses and were thus essentially incidental to holding the property. Appellant's characterization of the activities suggests that the taxpayer's chief concern was carrying on an active liquidation campaign, seeking buyers at large, and selling or attempting to sell a piece here and a parcel there whenever it could get its price. Nothing of the sort occurred. Rather, it is fair to say, as we have already stated, that the taxpayer's activities were reduced to such acts as were necessary to hold and carry its property and maintain its existence until it might succeed in its efforts to liquidate by a single sale of the property as a whole.

Appellant's purpose in so over-emphasizing liquidation is to bring the case as far as possible within the holding of the court in the *Washington Realty Corp.* case, upon which appellant strongly relies. The cases, however, are not comparable.

4. The instant case is not controlled by Magruder v. Washington, Baltimore, and Annapolis Realty Corp.

Appellant admits, even after erroneously characterizing the activities of the taxpayer as solely "acts of liquidation" (Br. p. 17), that the present case is "not on all fours" with that case (Br. p. 16). It is not; and the distinction, which is both obvious and significant, is threefold:

First, the taxpayer there was organized by a bondholders' committee of a defunct corporation *for the purpose of liquidating properties acquired from such corporation through foreclosure.* The taxpayer here was not organized as a liquidating corporation but to carry on an active lumber business on lands which it expected to have served by a proposed railroad branch which would render such active business profitable in the opinion of taxpayer's incorporators.

Second, the taxpayer in the Supreme Court case was actually engaged in the business which was the prime object of its incorporation. The taxpayer here was not carrying out the purpose of its incorporation, but its activities were limited to those necessary and incidental to the holding of its property until its liquidation could be accomplished, and to negotiations for the sale of the property as a whole to accomplish such liquidation.

Third, as already pointed out, in contrast to the taxpayer there, the taxpayer here was not in any proper sense of the word actually engaged in liquidating. Its *liquidation* activities were minor and were

solely incidental to its function of *holding* its properties.

The cases therefore are widely different.

Appellant finds no indication in the *Washington Realty Corp.* case that activities looking toward liquidation, when carried on by a corporation organized for the purpose of liquidation, should be distinguished from similar activities of a corporation organized for another purpose (Br. 16). We think that distinction is plainly indicated in the *Washington Realty Corp.* case and in other decisions both of the Supreme Court and of the lower courts.

In the *Washington Realty Corp.* case, after stating that the corporation had not reached the state of quietude illustrated by the *Zonne* case, the court said in the most decisive sentence in its terse opinion (316 U.S. at p. 73):

> "On the contrary, respondent was actually engaged in fulfilling the purpose of its creation, the liquidation of its holdings for the best obtainable price."

This sentence is especially meaningful in the light of the lower court decisions in the same case. The District Court had declared (*Washington, Baltimore & Annapolis Realty Corp. v. Magruder*, 35 Fed. Sup. 340, at page 342):

> "I reach the conclusion from the evidence in this case that all the activities of this company were solely related to the liquidation of these assets, and that for this reason its stock is exempt from the taxes in question. In short, while neither the Supreme Court nor the Circuit Court of Appeals for this Circuit has yet been called upon to determine

whether a *purely liquidating corporation* of this precise character is exempt from the provisions of the acts in question, I believe the necessary inference from such decisions as do exist, interpreting the clause 'carrying on or doing business', or synonymous terminology, require an affirmative answer to this question." (Emphasis supplied.)

The Circuit Court of Appeals had said (*Magruder v. Washington, Baltimore & Annapolis Realty Corp.* (C.C.A. 4th), 120 Fed.(2d) 441, at page 443):

"It is contended on behalf of the defendant that while a corporation originally organized to do business for profit engaged in liquidating its own assets might not be liable for the tax, yet the plaintiff, *organized solely for the purpose of liquidating another corporation,* is liable. We are of the opinion that this contention is not a valid one." (Emphasis supplied.)

Clearly, then, the Supreme Court's statement that, "On the contrary, respondent was actually engaged in fulfilling the purpose of its creation", was in direct answer to the position taken by the lower courts.

The converse situation, where liquidation was not the primary object, was dealt with by the Supreme Court in *United States v. Emery, Bird, Thayer Realty Co.*, above. There, it will be recalled, the corporation held not to be doing business was organized to hold title to property leased to the Dry Goods Company and to distribute the proceeds, with power also to enforce the lease and sell the property. The court observed that the powers of the corporation were very nearly limited to the necessary in-

cidents of holding a specific tract of land, the corporation's "characteristic charter function." It then added (237 U.S. at page 32):

> "The possible sale of the whole would be merely the winding up of the corporation. That of a part would signify that the dry goods company did not need it."

The court could not more clearly have stated that mere liquidation of itself does not constitute doing business.

Lower court decisions are to the same effect. In

Lane Timber Co. v. Hynson (C.C.A. 5th, 1925) 4 Fed.(2d) 666,

a corporation was organized for the general purposes of dealing in real estate, stumpage, logs, timber and building materials (purposes, by the way, which are not the same as engaging in the lumber business, the principal purpose of the present taxpayer). It had long held a single piece of property and had employed agents to sell it, which the agents continuously made efforts to do without success. Beyond that, the corporation had merely held the land and paid taxes. The court held that owning land is not doing business, nor is paying taxes, and that neither had the efforts of the corporation's agents to sell the land rendered it liable. As the court appropriately observed (4 Fed.(2d) at page 666):

> "Most owners of land, whether corporations or individuals, would be willing to sell at a profit."

In

Johnson's Estate v. U. S. (Ct. Cl., 1940) 37 F.S. 617,

the corporation was organized to deal in real estate for

profit and did so for 25 years, at the end of which time it declared, by resolution of its directors, that its activities would thenceforth be confined to the liquidation of its assets and the preservation of its property. The court held the liquidation activities did not render it subject to the tax. It said (p. 623):

> "As a matter of course it endeavored in closing out this property to make a profit and the condition of the real estate market at the time rendered the process of liquidation rather slow, *but this court has held that the fact that a profit is sought in the liquidating process is not sufficient to make the corporation subject to the tax.*" (Emphasis supplied.)

The court distinguished *Edwards v. Chile Copper Co.*, above, on the ground that that corporation was doing what it was primarily organized to do, saying (p. 624):

> "In the instant case, an examination of the purpose clause in the certificate of plaintiff's incorporation (as set out in Finding 5) shows a long list of activities nearly all of which had been abandoned. In fact only the holding, owning, and selling of real estate remained and the principal purpose was not profit but to liquidate the estate."

The court aptly observed (p. 623):

> "If the property had been left in the hands of the executor [the original assets of the corporation having been received from the estate of a decedent] and he had proceeded to do the same things which were done by the corporation in the liquidating process, no one would contend that the executor was carrying on a business."

It is very evident therefore that whether or not a corporation whose activities consist of liquidating its properties has been organized for that purpose is of vital importance on the question whether such liquidation activities constitute carrying on or doing business within the meaning of the capital stock tax law. The fact that the taxpayer in the *Washington Realty Corp.* case was organized as a liquidating corporation was essential to the result reached by the Court, and that case is therefore to be distinguished from this one where the taxpayer is not a liquidating corporation.

Thus the authority upon which appellant relies in this case fails to support its position. Appellant's argument fails for the further reason that it is not well founded in fact. The activities of the taxpayer here cannot properly be characterized as "acts of liquidation". They were directed to holding its timberlands, receiving the avails thereof and maintaining its corporate existence, and whatever aspects of liquidation any of its activities may have had were entirely incidental to that purpose and due to the nature of the taxpayer's property as a wasting asset.

5. The taxpayer's activities under the stumpage contracts amounted to no more than receiving certain ordinary fruits of the ownership of standing timber on a minor and isolated part of the taxpayer's properties.

Were it not for the stumpage contracts there would be no question that during the taxable years the taxpayer was merely owning its property and maintaining its corporate existence and was not carrying on or doing business. Capital stock taxes paid by the taxpayer in the years 1923 to 1926, inclusive, were refunded to the tax-

payer on the ground it was not then engaged in doing business; and the District Court expressly found that the receipt of income under the stumpage contracts constituted the only difference between the activities of the company during the taxable years and its activities during the period from 1922 to 1926 when the company was not engaged in business (R. 112-113). Although the entire activities of the taxpayer must be considered as a whole in determining whether or not it is doing business, still, under the present facts, the effect of the stumpage contracts must be the decisive factor.

Now, it is clear that the mere negotiating and execution of the stumpage contracts—only one supplemental agreement was actually executed during any of the taxable years—did not of itself constitute doing business. The three stumpage contracts were in effect but a single arrangement for the cutting of timber by the Santa Cruz Lumber Company on a small portion of the holdings, and they were the only transactions of the kind ever entered into by the taxpayer. Even they were a mere expedient in aid of the taxpayer's major purpose and activity, the holding of its lands. This single continuing arrangement therefore did not put the taxpayer in the business of dealing in timber lands or stumpage, and we do not understand appellant to make any claim to the contrary. The mere execution of the stumpage agreements no more constituted the doing of business within the meaning of the capital stock tax law than did the execution of the leases by the taxpayers in *United States v. Emery, Bird, Thayer Realty Co.*, and *Zonne v. Minneapolis Syndicate.*

After the stumpage contracts had been executed they involved no further activity whatever on the part of the taxpayer except receiving the payments under the contracts from the Santa Cruz Lumber Company and paying part of the wages of the tallyman. The taxpayer did not cut or remove the timber; that was done entirely by Santa Cruz Lumber Company, which had the entire management and conduct of and responsibility for the operations.

The receipt of the payments had no different effect from the receipt of rental payments under the leases in the *Emery, Bird, Thayer Realty Co., Zonne,* and *Minehill Ry. cases.* It represented merely the receipt of the avails of the taxpayer's property. The only difference between this case and those, in this respect, is in the use to which the properties were put under the contracts with the taxpayers.

The reservation by the taxpayer of the right of inspection and the contribution to the wages of the tallyman pursuant to the stumpage contracts, both were for the purpose of enabling the taxpayer to enforce performance of the agreements according to their terms and did not alter the status of the taxpayer. In the *Emery, Bird, Thayer Realty Company* case the taxpayer's chartered powers included the power to enforce the lease of its property, and in the *Minehill Railway* case the taxpayer maintained its corporate powers and held itself ready to exercise its franchise of eminent domain or other powers if and when required by the lessee. In neither case did these reserved powers render the taxpayer liable for the tax. It has been held, further, that the actual exercise

of such powers pursuant to the terms of such a lease does not result in the corporation doing business.

> *New York Central & H. R.R. Co. v. Gill* (C.C.A. 1st, 1915) 219 Fed. 184;
>
> *Traction Companies v. Collector* (C.C.A. 6th, 1915) 223 Fed. 984.

The present case, indeed, would seem to be a clearer case in favor of the taxpayer than either the *Zonne,* the *Emery, Bird, Thayer Realty Co.,* or the *Minehill Ry.* cases, for several reasons. First, in those cases, as well as in many others following them, the taxpayer's *entire* properties were devoted to income producing purposes, whereas in the present case the stumpage contracts involved only 1860 acres out of 13,000 acres of timberlands owned by the taxpayer. Eighty-five percent of the taxpayer's holdings were being held idle and put to no use by anyone.

Second, in each of those cases and many another case following them, the mere holding of the taxpayer's property was profitable to the taxpayer in the sense that it produced an income which was distributed to the stockholders in the form of dividends. In the present case no such income was derived from the stumpage contracts, the entire proceeds of which were devoted to the payment of expenses incident to the holding of the land and payment of the taxpayer's indebtedness, despite which a substantial deficit still exists.

Third, and more significant still, there is nothing in the instant case comparable to the income received by the taxpayer in the *Minehill Ry.* case from its investment of

assets in its "contingent fund" which, like the income from the lease, the court said amounted to no more than the ordinary fruits of ownership. For a similar case in this respect, see

> *Northern Pa. R. Co. v. Rothensies* (D.C. E.D. Pa., 1942) 45 F.S. 486.

Here there was no such activity on the part of the taxpayer as the investment and re-investment of the avails of its property, but only three isolated contracts, constituting in essence but a single arrangement, entered into substantially before the taxable years, and no further activity except receiving the payments and paying the tallyman.

No significance is to be attached to the fact that, because of the nature of timberlands as a wasting asset, the carrying out of the stumpage contracts resulted in a virtual liquidation of the small portion of the lands affected thereby. The properties leased by the taxpayers in the *Zonne, Emery, Bird, Thayer Realty Co.* and *Minehill Railway* cases were also subject to depreciation, and the difference is only one of degree. Mining property is similarly a wasting asset, and in

> *United Mercury Mines Co v. Viley* (D.C. D. Ida., S.D., 1937) 20 F.S. 734,

a corporation which had reduced its activities to holding title to mining claims subject to a mining lease and option, payments on which were to be applied to the purchase price, and to receiving and distributing the avails, was held not doing business.

The Supreme Court cases to which we have referred so frequently, of course, are not factually identical to the instant case. The differences, however, are differences in detail and not in substance and the principles applied in those cases are equally applicable here. Although we prefer to base our position, as we have, upon the principles rather than to place our reliance upon mere factual similarities, there is no dearth of cases offering such factual similarities. Among such may be mentioned the following:

Lane Lumber Co. v. Hynson (C.C.A. 5th, 1925) 4 Fed.(2d) 666;

United States v. Hotchkiss Redwood Company (C.C.A. 9th, 1928) 25 Fed.(2d) 958;

Clallam Lumber Co. v. United States (D.C. W.D. Mich. S. D., 1924) 34 Fed.(2d) 944, (1929) 34 Fed.(2d) 947, (1940) 37 F.S. 542 (three cases with the same title involving different years).

The *Clallam Lumber Company* cases, it may be remarked, are not as strong in favor of exemption from the tax as the present case because, although the express purposes stated in the articles were similar to those of the present taxpayer, it appeared that the prime reason for incorporating was to unify various individual holdings so as to make it possible to sell the lands to greater advantage. Yet, notwithstanding that fact, the corporation three times was held not liable for the tax.

6. The taxpayer has reduced its activities to the mere owning and holding of specific property and the distribution of the avails and the doing only of such acts as may be necessary for the maintenance of its corporate status; under the Regulations the taxpayer was not doing business.

We think it must be clear from the foregoing discussion that the activities of the taxpayer bear no resemblance to those described in Article 43(a) of Treasury Regulations 64 (1936 ed.) set forth on page 4 of appellant's brief. It has not been "buying, selling, manufacturing, developing, financing, speculating or otherwise dealing in property" within subdivision (1) of that Article. It has not been "furnishing services of any character" under subdivision (2). It has not been "leasing or managing properties, collecting rents or royalties" according to subdivision (3). Certainly it has not engaged in "the ordinary liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distributing the proceeds as liquidation is effected" within the meaning of subdivision (5); and, of course, it was subdivision (5) on which the Supreme Court's decision in *Magruder v. Washington, Baltimore etc. Realty Corp.* was solely based. Moreover, the taxpayer has not engaged in any other activity for the purpose of a livelihood, profit or gain, or in any other way "coming within the ordinary and natural signification of 'carrying on or doing business' ", within subdivision (6).

On the contrary, the activities of the taxpayer are aptly described by Exception 2 under paragraph (b) of Article 43 of those Regulations, namely:

> "(2) the distribution of the avails of property and the doing only of such acts as may be necessary for the maintenance of its corporate status in the case in which the organization either was organized for, or reduced its activities to, the mere owning or holding of specific property."

There may perhaps be some overlapping as between this "holding company" provision in Article 43(b)(2) and the "liquidating company" provision in Article 43(a)(5); or, to put it another way, there may be some doubtful ground between the two provisions so that in some cases it may be difficult to draw the line which separates them. Sometimes a corporation may be concurrently engaged in both holding and liquidating. The Supreme Court recognized this in the *Washington Realty Corp.* case, for it considered both provisions in its opinion and finally held that the "liquidating company" provision fitted the facts of that case so perfectly that it was controlling, regardless of whether the "holding company" provision was partially applicable. There, however, liquidation constituted the primary and fundamental purpose of the corporation; liquidating activities were its major activities, covering all of its properties, and the holding of the properties was merely incidental to liquidation.

Our case is the converse. The original primary and fundamental purpose of the taxpayer was to do an active lumber business, but by reason of an event beyond its control—the failure of the railroad to construct a branch line—this purpose of taxpayer was changed to the holding of its properties for an indefinite time until a sale of them as a whole could be advantageously made. During

the taxable years no such sale was imminent and the fundamental and primary purpose was to remain a holding company. The principal activities during the taxable years were the holding and preservation of the taxpayer's properties and the maintenance of its corporate status in good standing. The taxpayer did engage in minor liquidating activities, but these affected only a small and isolated part of its properties and were solely for the purpose of enabling it to continue to hold its main block of timber and maintain its corporate status.

Therefore, in considering which provision of the Articles applies—as between the "liquidating company" provision and the "holding company" provision—it is clear that in our case the facts rendering the "holding company" provision applicable strongly outweigh the facts which would bring the "liquidating company" provision into effect.

CONCLUSION.

In conclusion it is submitted that for the reasons summarized in the last preceding portion of this brief, the decision between the two possibly applicable provisions of the regulations, namely, the "liquidating company" provision and the "holding company" provision, should be made on the basis of the facts showing the primary purpose and principal activities of the taxpayer, just as such decision was made by the Supreme Court in the *Washington Realty Corp.* case. Here the primary purpose and the principal activities during the taxable years classified the taxpayer as a holding company within

Article 43(b)(2), which provides that such a holding company is not doing business within the meaning of the capital stock tax laws. Such classification also accords with the ordinary common-sense understanding of the term "doing business" and with the general principles laid down by the Federal court decisions.

It is submitted that the District Court's conclusions are supported by the facts found and that the judgment is consistent with the facts and in accordance with law. It should be affirmed.

Dated, December 14, 1942.

Respectfully submitted,

A. Crawford Greene,
Henry D. Costigan,
Scott Elder,
Attorneys for Appellee.

McCutchen, Olney, Mannon & Greene,
Of Counsel.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

SAN FERNANDO MISSION LAND COMPANY, a corporation, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 10,272 Apr. 27, 1943

Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Before: DENMAN, MATHEWS and STEPHENS, Circuit Judges.

STEPHENS, Circuit Judge.

The petitioner asks us upon review to reverse the decision of the Board of Tax Appeals (now United States Tax Court) to the effect that there was a deficiency in excess profits tax liability of petitioner for the taxable year of 1938 in the sum of $8,035.64. There is no factual issue present, and this petition must be granted if petitioner was not "carrying on or doing business" during any part of the capital stock tax year ending June 30, 1938, within the meaning of § 601(a) of the Revenue Act of 1938. "For each year ending June 30, beginning with the year ending June 30, 1938, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock."

The following, mainly taken from respondent's brief, is a fair recitation of the facts:

> Taxpayer is a California corporation with principal office at Los Angeles, California, and filed its 1938 income tax return with the Collector there. It was organized in 1904 to buy, develop, and sell land; it acquired over 16,000 acres

about fifteen miles from the center of Los Angeles, and engaged actively and successfully in the development and sale of this tract. In 1918 it declared a dividend of $1,000,000 which it paid by a distribution of lands among its shareholders. Thereafter it donated some land to the city for parks, restricted its business activity, reduced its capitalization from $1,000,000 to $100,000, and distributed $1,250,000 in a series of dividends, the last being one of $100,000 paid on January 29, 1923. Few assets remained, and shareholders displayed little interest in the corporation, but it was not dissolved. After a meeting on February 2, 1927, the directors did not again meet for nearly a decade. On state franchise tax returns, taxpayer was described as "practically liquidated."

Taxpayer's remaining properties after 1930 consisted of a thirty-five acre grove of orange and lemon trees, 138 acres of unplotted hill lands, reservations of mineral rights in some 3,000 acres of land previously sold, and a very small amount of cash. The grove was in poor condition, unprofitably operated for many years, and in 1937 the trees were uprooted and it was abandoned to the state for unpaid taxes. The hill lands lying some twenty miles from the center of Los Angeles were without improvements or available water. Of the original acreage, they constituted a part for which no buyer was found. (As described by petitioner in his opening brief, these unsold lands were "tail-end" pieces.) The grove and these lands were carried on taxpayer's books at $52,500 and $13,800, respectively. The reservations of mineral rights were carried at one dollar. In selling its real estate, taxpayer had in some cases reserved mineral rights and as in early years had authorized its officers to execute oil and gas leases. The board of directors in 1925 gave consideration to proposals for oil leases, and at the meeting on February 2, 1927, they considered several proposals and ratified a release of the reserved rights in certain land for a consideration of $2,940. At the same time they resolved to make no more such releases "for the present, at least."

After 1930, taxpayer operated the grove at a continual loss; in 1932 it made one sale of realty for about $1,500; in 1935 it rented pasture for $75, and in 1936 it received $7,500

for release of oil reservations and for a lot. Taxes and expenses exceeded income except in 1936, and the balance sheet constantly showed a deficit of about $40,000 during the period. In 1936 no oil had been found on or near taxpayer's properties and no survey for oil had been made. At the instigation of the president of one of taxpayer's creditors, the directors met on September 14, 1936, and elected him president. He entered into negotiations for the leasing of oil rights. A lease, authorized by the directors and placed in escrow on November 10, 1937, was not delivered because of the lessee's failure to perform conditions. On his initiative, the grove was abandoned in the fall of 1937.

During the fiscal year July 1, 1937-June 30, 1938, taxpayer received $51.87 in the sale of fruit; $50 from the rental of pasture; and two other small items. From the sale of 4.75 acres of the hill lands it realized a profit of $1,890 and in the sale of reserved oil rights it received $1,180. Its total income was $3,270.66, and its expenses and taxes were $2,897.34. On March 16, 1938, taxpayer made a twenty-year lease of oil rights for royalties which are being paid. On August 26, 1938, it made a lease of oil rights for $20,000 and royalties from oil as long as produced.

Taxpayer received income from its leases in 1938, 1939 and 1940, and declared dividends in each of those years.

On August 26, 1938, taxpayer employed Robert V. New to promote and negotiate oil leases. His compensation was to be based on the amount of rental. Through New's efforts, taxpayer made a lease of oil rights on November 25, 1938, for a minimum period of twenty years, receiving $76,130 and the right to a royalty. Pursuant to the employment agreement, taxpayer paid New $33,306.88 for negotiating this lease and paid an attorney $250 for preparing the instrument.

Thus it will be seen that taxpayer succeeded in selling for profit most of its lands (its main purpose and business) during the first few years of its existence and remained comparatively, in fact almost completely, inactive for several years. However, it was not dissolved, and when the opportunity came, as it did in one instance, it made a sale of a substantial portion of its remaining land holdings at a profit. When the prospect brightened for the

development of oil upon its properties and through reserved oil rights, petitioner's attention to the profit motive became active. This oil prospect revival prevailed within the tax paying period here involved, and taxpayer took advantage of it.

The proper application of the phrase "carrying on or doing business" as it is used in tax statutes was fully considered in Flint v. Stone-Tracy Co., 220 U.S. 107 and therein the Supreme Court approved the statement found in other judicial opinions that the word "business" as it is used in the phrase under examination includes "that which occupies the time, attention and labor of men for the purpose of a livelihood or profit." In Von Baumbach v. Sargent Land Co., 242 U.S. 503 at pp. 514, et seq., the Supreme Court again approved this statement, proceeded to trace the Supreme Court's course in the matter down to the time of decision in the cited case, and concluded that "The fair test to be derived from a consideration of all of them [referring to the cited cases] is between a corporation which has reduced its activities to the owning and holding of property and the distribution of its avails and doing only the acts necessary to continue that status, and one which is still active and is maintaining its organization for the purpose of continued efforts in the pursuit of profit and gain and such activities as are essential to those purposes."

Thus the rule is clear, but as is indicated in the judicial history of the subject, there appears sometimes a twilight zone of fact wherein the objective does not appear in definite outline. With this in mind the Second Circuit in Argonaut Consolidated Mining Co. v. Anderson, 52 Fed.(2d) 55, said, "That there is a degree of quietude which will exempt" a corporation from paying the tax "is indeed well settled." It is then stated in the opinion that in most of the cases therein cited wherein the corporation has not been required to pay the tax the corporation's activities "have been confined to holding the title of property, whose usufruct it receives and distributes in dividends."

This court has adhered to these guiding principles in Porter v. Commissioner, 130 Fed.(2d) 276. Commissioner v. Boeing, 106 Fed.(2d) 305, and United States v. Metcalf, 131 Fed.(2d) 677.

The facts of the instant case conclusively support the Board's holding that the petitioner was carrying on and was doing business in the period for which the tax was levied when measured

by either the affirmative rule pronounced in the Von Baumbach case (supra), or by the negative rule pronounced in the Argonaut case (supra) or by both of these rules.

If more were needed the treasury administrative regulations set out and applied in Magruder v. Realty Corporation, 316 U.S. 69, would be important. But we find no *twilight zone,* no *uncertain degree of quietude,* no *nuances of facts* for the tax period with which we are here concerned and therefore find no occasion for calling these regulations to the aid of the judicial process.

Affirmed.

(Endorsed:) Opinion. Filed Apr. 27, 1943. Paul P. O'Brien, Clerk.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO. 4/28/43—100.

No. 10289

United States
Circuit Court of Appeals
For the Ninth Circuit.

LOMBARD TRUSTEES, LTD., a Trust, and CHARLES S. LOMBARD, BERTHA M. LOMBARD and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the Tax Court of the United States

ROTARY COLORPRINT. 590 FOLSOM ST., SAN FRANCISCO

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. Docket No. 104687

LOMBARD TRUSTEES, LTD., a trust, and CHARLES S. LOMBARD, BERTHA M. LOMBARD and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

AGREED STATEMENT OF THE CASE ON APPEAL

Pursuant to Rule 76 of the Rules of Civil Procedure for the District Courts of the United States, the parties by their respective counsel, make and sign this Statement of The Case, as follows:

1. Petitioner timely filed with the Collector for the Sixth District of California a fiduciary return of income, Form 1041, for the calendar year 1937. In such return, petitioner's net income before any distribuition to beneficiaries was reported to be $23,014.05.

On June 15, 1940, respondent mailed to petitioner a notice of determination of deficiency in petitioner's income and excess profits taxes for 1937. In said notice, respondent stated:

> "It is held that your organization is an association within the meaning of section 1001

of the Revenue Act of 1936 and as such you are taxable as a corporation upon your [1*] net income for the period February 10, 1937 to December 31, 1937.

Since it is determined that your organization is an association taxable as a corporation for the period February 10, to December 31, 1937, the deduction claimed for the amount distributable to beneficiaries, $23,014.05, is disallowed and there is eliminated the prorated net income for the period January 1 to February 9, 1937, after giving effect to adjustments (a), (b) and (c), in the amount of $2,509.81, which amount is taxable to the grantor of the trust and is not a part of the net income of the association."

In said notice it was stated that respondent determined the net income for 1937 amounted to $22,902.04; that respondent apportioned such income on a daily basis to February 10th, and that $2,509.81 was the net income prior to February 10th and was taxable to the grantor of the trust and that $20,392.23 was the net income after February 9th and was taxable to petitioner as an association at rates applicable to corporations and respondent determined there was a deficiency in income tax of $5,001.09 and in excess profits tax of $2,015.10.

2. Thereafter, petitioner petitioned the United States Board of Tax Appeals for a redetermination

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*Page numbering appearing at top of page of original certified Transcript of Record.

of the deficiency found by respondent. The cause was heard at Los Angeles on June 10, 1941. At such hearing respondent filed an amended answer in which respondent alleged petitioner was an association taxable as a corporation during the entire year of 1937.

3. At said hearing the following were offered and received in evidence:

(a) Petitioner's said fiduciary return for 1937 wherein items of income, deductions and distributions to [2] beneficiaries were reported in the manner stated in the findings and opinion of the Board of Tax Appeals;

(b) Gift tax return of Dr. Charles S. Lombard for the year 1935, wherein he reported transfers to petitioner during 1935 of the parcels of property and with the respective values stated in the findings and opinion of the Board;

(c) Two stipulations, therein denominated as "Stipulation A" and "Stipulation B", respectively.

There was no other evidence and the cause was submitted on said fiduciary return, gift tax return and stipulations.

4. Attached hereto and respectively marked as hereinafter stated are the following:

Exhibit 1, being a copy of said Stipulation A (caption deleted and exhibits attached or incorporated by reference omitted from such copy and made separate exhibits);

Exhibit 2, being a copy of said Stipulation B (caption deleted);

Exhibit 3, being a copy of the conveyance and contract dated November 3, 1935 referred to in paragraph 3 of Stipulation A (property descriptions and notarial certificates omitted);

Exhibit 4, being a copy of the "instructions as to beneficiaries", dated November 3, 1935, referred to in paragraph 3 of Stipulation A; [3]

Exhibit 5, being a copy of the "request to vacate registration", dated February 10, 1937, referred to in paragraph 9 of Stipulation A;

Exhibit 6, being a copy of the resolution adopted March 14, 1937, referred to in paragraph 10 of Stipulation A;

Exhibit 7, being a statement of nature and contents of, with quotations from, the Amended Declaration of Trust, dated September 30, 1938. referred to in paragraph 13 of Stipulation A;

Exhibit 8, being a copy of Memorandum Findings of Fact and Opinion of Board of Tax Appeals, entered May 6, 1942;

Exhibit 9, being a copy of the Decision of said Board, entered June 19, 1942;

Exhibit 10, being a copy of the Petition for Review of Decision of Board of Tax Appeals, with its filing date.

5. The points relied on by petitioner on appeal are:

(a) Said decision is contrary to law in that

thereby income taxes for the year of 1937 are imposed upon petitioner in excess of any income taxes for which petitioner was liable;

(b) Said decision is contrary to law in that thereby excess profits taxes for the year 1937 are imposed upon petitioner and petitioner was not liable during said year for the payment of excess profits taxes;

(c) Said Board erred in finding petitioner was an association taxable as a corporation and erred in not finding that petitioner was a trust taxable as such; [4]

(d) Assuming but not admitting that petitioner was an association during some time in 1937, said Board erred in finding petitioner was an association during all of 1937, and erred in not finding petitioner was an association only subsequent to March 13, 1937;

(e) Said Board erred in holding the purpose of the trust involved was shown by and in the written declaration of trust and in rejecting and not considering other evidence of the purpose of the trust;

(f) Said Board erred in holding that the Board could not consider any evidence of the purpose of the trust other than that which appeared in the written declaration of trust, and

erred in not considering all evidence of purpose.

GEO. W. HELLYER
JOHN B. SURR
Attorneys for Petitioner
J. P. WENCHEL
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent

Approved and ordered filed:
(Signed) MARION J. HARRON
Board Member [5]

CERTIFICATE

I, B. D. Gamble, Clerk of the United States Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 5, inclusive, contain and are the agreed statement of the case made and entered into by the respective parties on review appearing by their counsel of record and that the copies of pleadings and proceedings attached thereto as exhibits are true copies of such proceedings, pleadings and exhibits as are on file in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 9th day of Oct., 1942.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals [5-A]

EXHIBIT 1

Stipulation A

It Is Hereby Stipulated and Agreed, by and between the parties hereto, through their respective counsel, that this cause may be submitted upon the following stipulation of facts, without prejudice, however, to the right of either party hereto to submit such additional evidence at the hearing before the Board as shall not be inconsistent with this stipulation of facts.

1. The use of the words, or terms, "trust", "trustor", "trustors", "trustee", "trustees", or similar expressions, in any instrument referred to herein, or in this stipulation, shall not be deemed an admission by any party as to the nature or legal effect of the instrument employing such terms, or an admission opposed to the contentions of such party, and the use of each and all such terms, shall be without prejudice to the right of any party to attribute to such words a meaning conforming to the contentions of the party.

2. Charles S. Lombard (commonly known as, and herein, for ease in identification, generally referred to as "Dr. Lombard") and Bertha M. Lombard (both of said persons being hereinafter sometimes called "trustors") intermarried on April 6, 1907, and at all times since have been, and now are, husband and wife and residents of the City of Redlands, San Bernardino County, California.

Three children were born of said marriage. Said children were surviving on November 3, 1935, and

still survive, their respective names and dates of birth being: [6]

Emily F. Lombard, born January 27, 1909.

Winthrop C. Lombard, born February 15, 1910.

Ruth Lombard Paul, born September 20, 1913.

Each of the said trustors had previously been married, and during the times hereinbefore referred to had children of the former marriage surviving.

On November 3, 1935, surviving children of Dr. Lombard's first marriage were:

Lillis L. Stowe, born August 18, 1883.

George S. Lombard, born January 18, 1885.

Charles Sumner Lombard, Jr., born November 29, 1886.

Norman M. Lombard, born May 25, 1891.

On November 3, 1935, surviving children of Bertha M. Lombard's first marriage were:

Ralph M. Pray, born July 24, 1898.

Dorothy E. Pray, born August 17, 1900.

3. On November 3, 1935, at Redlands, California, Dr. Lombard and wife executed an instrument (therein and hereinafter termed "conveyance and contract"), of which a copy is attached to the petition herein and there marked "Exhibit A", and the same is incorporated herein by reference. At the same time, said conveyance and contract was also executed by Winthrop C. Lombard, Norman M. Lombard and Emily F. Lombard, who were therein termed "trustees".

At the time of the execution of said conveyance

and contract (Exhibit A of the petition), the said Norman M. Lombard executed an instrument (therein and hereinafter called "instructions as to beneficiaries"), of which a copy is attached to the petition herein, and there marked "Exhibit B", and the same is incorporated [7] herein by reference.

4. Said conveyance and contract (Exhibit A of petition) and said instructions as to beneficiaries (Exhibit B of petition) were executed as a part of and to evidence a single transaction and agreement, and both of said instruments are hereinafter referred to as the "trust delcaration", and the arrangement thereby effected is hereinafter referred to as "a trust", or "the trust", without prejudice to the claims of any party respecting its effect, vadility or taxability.

5. All parties to said trust declaration were residents of the State of California. All real property then or thereafter affected by or subject to said trust declaration was situate in the State of California and the situs of all personal property then or thereafter affected by or subject to said trust declaration was in said state. Said conveyance and contract was recorded in the office of the County Recorder of said County of San Bernardino on November 14, 1935, in Book 1108 of Official Records, at page 1 thereof.

6. On November 3, 1935, Emily F. Lombard and Winthrop C. Lombard resigned and ceased to act as or be trustees of said trust, and at the same time, Dr. Lombard and his wife were constituted and

made trustees of said trust, and at all times since, the trustees of said trust have been, and now are, Dr. Lombard, his wife and his son, Norman M. Lombard.

7. The property described in and transferred to said trustees by said conveyance and contract was a business property in said City of Redlands, then and since rented. From time to time after the execution of said trust declaration and prior to March 14, 1937, other real or personal properties were transferred to the [8] trustees by Dr. Lombard, without consideration. Included in said property so transferred were seven parcels of California real estate that were valued at $128,500 in the 1937 gift tax return of Dr. Lombard. For the purpose of this case only, the approximate value of all property so transferred was $300,000.

8. At the time of the establishment of the trust 600 of the "expectancy fractions" provided for in the trust declaration were registered on the records of the trustees in the name of Dr. Lombard.

9. A meeting of the trustees was held March 14, 1937. At such meeting, there was received by the trustees an instrument dated February 10, 1937, signed by Dr. Lombard and entitled "request to vacate registration". A copy of said instrument is hereto attached as Exhibit 1 and incorporated herein by reference.

10. At said meeting of trustees on March 14, 1937, the trustees adopted a resolution of which a copy is hereto attached as Exhibit 2 and incorporated herein by reference.

Pursuant to the request (Exhibit 1) and resolution (Exhibit 2) said 600 "expectancy fractions" were, on March 14, 1937, registered on the records of the trustees in the manner provided in said request (Exhibit 1).

11. A meeting of the trustees was held February 26, 1938. At such meeting there was received by the trustees an instrument dated February 25, 1938, signed by Dr. Lombard and wife, entitled "request to vacate registration". A copy of said instrument last mentioned is hereto attached as Exhibit 3 and incorporated herein by reference. [9]

12. At said meeting of trustees on February 26, 1938, the trustees adopted a resolution of which a copy is hereto attached as Exhibit 4 and incorporated herein by reference.

Pursuant to the request (Exhibit 3) and resolution (Exhibit 4), the 350 "expectancy fractions" theretofore registered in the names of Dr. Lombard and wife, as joint tenants, were on February 26, 1938, registered in the manner provided in said request (Exhibit 3).

13. On or about September 30, 1938, Dr. Lombard and wife, and the eight children in whose names "expectancy fractions" had theretofore been registered on the books of the trustees, executed and acknowledged an instrument in writing therein and hereinafter referred to as "Amended Declaration of Trust", of which instrument a copy is hereto attached as Exhibit 5 and incorporated herein by reference. Said Amended Trust Declaration (Exhibit 5) was recorded in the office of the County

Recorder of said San Bernardino County, on October 20, 1938, in Book 1297, page 386 of Official Records.

14. No transfers of "expectancy fractions" or of beneficial interests in the trust have ever been made, other than those made at the times, in the manner and by the instruments hereinbefore referred to. No "expectancy fractions" were ever registered in the records of the trustees, other than the 600 first registered in the name of Dr. Lombard and thereafter re-registered as hereinbefore set forth. All transfers of "expectancy fractions", or beneficial interests in the trust to said eight children, were made without consideration other than love and affection. [10]

15. On June 14, 1940, petitioner mailed to the Collector of Internal Revenue at Los Angeles a duly executed caiptal stock tax return on form 707 for the year ending June 30, 1937, wherein the value of petitioner's "capital stock" was declared to be $150,000. With said return petitioner enclosed a check for payment of the tax, penalty and interest shown thereon and hereinafter stated. Said return was received by mail and filed with said Collector on June 15, 1940, and at said time petitioner paid said Collector the sum of $213.75 for the following:

Capital stock tax for year ending June 30, 1937	$150.00
25% penalty for delinquency	37.50
Interest from August 1, 1937	26.25
Total	$213.75

The amount so paid has never been refunded to petitioner and no claim for refund has been filed or made.

16. On March 15, 1938, petitioner filed with the Collector of Internal Revenue at Los Angeles a duly executed fiduciary income tax return on form 1041, for the calendar year of 1937, reporting on a cash basis. Said return was verified by Dr. Lombard, who, after his signature to the affidavit, added the expression "mgr.".

The net income of the trust, reporting on a cash basis, for the full calendar year of 1937, was the sum of $22,902.04 (which is the amount determined by respondent), of which $4,234.95 was income from dividends.

The net income of the trust, reporting on a cash basis, for the period February 10, 1937 to December 31, 1937 (both dates inclusive) was the sum of $21,671.87, of which, $3,333.55 was income from dividends.

The net income of the trust, reporting on a cash basis [11] for the period March 14, 1937 to December 31, 1937 (both dates inclusive) was the sum of $8,482.39, of which, $3,333.55 was income from dividends.

The provisions of this paragraph 16 are subject to the provisions of paragraph 18 of this stipulation.

17. Included in the property conveyed by the trustors to the trustees and held by the trustees at all times during the year of 1936 and thereafter, was a citrus orchard at Redlands, comprising in

area about 46 acres, part navels and part valencias. In the vicinity of Redlands, navel oranges mature so as to be marketable in late November or early December and are generally picked and marketed during the months of December, January, February, March and April. On January 1, 1937, there was on said orchard a matured crop of navel oranges that was sold and picked as hereinafter stated. On February 23, 1937, said navel crop was sold to Jameson Company for the sum of $2.80 per hundred pounds, on the trees, the buyer to pick and haul, with the picking to commence March 1, 1937 and be fully completed by April 10, 1937. Said crop was picked by the buyer between March 1, 1937 and April 13, 1937. No expense was incurred or paid by the trustees or petitioner in connection with said crop after its sale on February 23, 1937. The trustees received for said crop the following amounts:

On February 23, 1937 (at the time of sale)	$10,000.00
On March 10, 1937	5,000.00
On April 15, 1937	1,868.96
Total	$16,868.96

[12]

18. In stating and in determining net income for different periods of 1937, as stated in paragraph 16 of this stipulation, each payment received for said navels was credited to gross income for the period in which received, and the entire proceeds from the navels in the amount of $16,868.96 was

credited to gross income for the full year of 1937, and also for the period February 10th to December 31st, 1937, and $1,868.96 of said proceeds was credited to gross income for the period March 14th to December 31st, 1937.

19. Subsequent to March 14, 1937, the only sales made by the trustees, apart from ranch products, were the following:

(a) On March 24, 1937, sold stock of American Trust Company costing $5,189.44 for $5,145.35 and bought stock of Baltimore American Insurance Company for $5,133.75;

(b) On July 13, 1938, sold bonds of Kansas City School for $5,520.75.

(Signed) GEO. W. HELLYER
Counsel for Petitioner

(Signed) J. P. WENCHEL FTH
Counsel for Respondent

[Endorsed]: Filed at Hearing June 10, 1941.

[13]

EXHIBIT 2

Stipulation B

It Is Hereby Stipulated and Agreed, by and between the parties hereto, through their respective counsel, that if Charles S. Lombard were called as a witness upon the hearing of this cause, he would testify (if permitted to testify over respondent's objection) as hereinafter set forth, provided that the Board considered such testimony material.

This stipulation is made subject to the objection of respondent to the admission of such testimony into the evidence, upon the ground that the testimony, and each part thereof, is immaterial, irrelevant and incompetent. The calling of said Charles S. Lombard and the giving of testimony is dispensed with. This stipulation may be offered and received at such hearing with the same effect as though the said Charles S. Lombard had been called and had testified over respondent's said objection, or had offered to testify as herein set forth, to which offer respondent had interposed said objection, and the objection had been sustained.

Following is said testimony:

1. I was born November 25, 1852, and at the time of executing the trust involved in this proceeding on November 3, 1935, was 83 years old.

My wife, Bertha M. Lombard, was born March 26, 1872. She is 19 years and 4 months my junior. At the time the trust was set up, there were living four children of my first marriage, their ages ranging from 52 years to 44 years. My oldest daughter of my first marriage is eleven years younger [14] than my wife and thirty years older than my youngest daughter by my said wife, Bertha.

2. At the time the trust was established, I owned real and personal property of the value of not less than $300,000. In addition to our residence at Redlands, California, there were seven parcels of real estate consisting principally of property rented and used for business and a 46-acre orange ranch.

3. I desired and intended that the four children

of my first marriage, the three children of my second marriage, and my wife's daughter of her first marriage (which daughter had been making her home with us) making a total of eight children, should ultimately share alike in this property.

My oldest daughter stated and contended that the children of my first marriage should be preferred over the others as I had accumulated considerable property before my second marriage.

4. I had been devoting my full time and energy to the property. I desired to relieve myself of some of the responsibility, and I desired and needed help in managing it.

My wife and I wanted more leisure. We planned to travel.

I expected my wife to survive me, and I desired to provide her with an income for her support as long as she lived.

For a long time several of the children had been wholly and others partially dependent on me. I desired to give them economic freedom by providing each with an independent income.

Finally, after I was gone, I wanted the children to be able to sell the various properties and divide the proceeds from time to time as the market justified. [15]

I was induced by all of the foregoing reasons to create a living trust.

5. I learned of the form of a trust called the "Hulbert Plan trust" from Wilson Brothers of Redlands. They had adopted it and gave me a copy of the plan that I read. I then contacted Elton

Goble of San Bernardino, California. He was engaged in real estate and insurance and was also the representative of the publishers of the Hulbert Plan trust. He sold me the plan. The copyrighted, stereotyped form was adopted and executed without change.

6. On September 28, 1935, there was a meeting at my home at Redlands, attended by six of said eight children, my wife and myself. The intention of my wife and self to place part or all the property in trust and to use for such purpose the Hulbert Plan trust form was then made known to said children and the matter was discussed.

My oldest daughter, Lillis, aged 52, and my son, Charles Jr., aged 49, objected to the establishment of the trust without an opportunity to study and consider it. Previous to the meeting, papers had been prepared for execution. These were not then executed, but copies were made for the children.

7. The papers establishing the trust were executed about 36 days after the meeting referred to. Copies of these are attached to the petition in this matter and there marked "Exhibit A" and "Exhibit B". The full beneficial interest in the trust was registered in my name and remained so registered until March 14, 1937. [16]

8. By March 14, 1937, five of the eight children approved the trust and stated they were willing or desired to become beneficiaries, and on said date, a beneficial interest in the trust was registered to each of said five children. At said time, three of the right children had not approved.

9. About July 25, 1937, one of said three approved, and early in 1938, the other two approved. On February 26, 1938, a beneficial interest in the trust was registered to each of said three children.

10. At the time of executing the trust declaration (Exhibits A and B to petition), I did not consult or have the benefit of expert advice regarding trusts, gift taxes or income taxes. I made a gift tax return for the year 1935 in which I returned the property transferred to the trustees in 1935 and paid a tax thereon. On the advice of the Treasury, I subsequently made gift tax returns for 1937 and 1938, reporting the beneficial interests transferred during those years, respectively, and paying gift tax thereon. The Treasury refunded, or caused to be refunded, the gift tax paid for 1935.

11. In 1936, my wife and I traveled for several months, visiting among other places, Mexico City, New Orleans, New England, Canada, Yellowstone and Alaska.

In 1937 my wife and I went to Europe on a five months' trip, visiting England, Ireland, Scotland, Holland, Belgium, Hungary, Germany, Austria, Switzerland, Italy and France.

(Signed) GEO. W. HELLYER
Counsel for Petitioner

(Signed) J. P. WENCHEL FTH
Counsel for Respondent

[Endorsed]: Filed at Hearing June 10, 1941. [17]

EXHIBIT 3

HULBERT PLAN

Conveyance and Contract

Whereby to Establish (not create) Property in Absolute Ownership in Natural Person Trustees, Who for Convenience, Use a Trade Name (to be proprietary without creating a fictitious entity) Common to Them as a Board: Requiring Strict Accounting: Proclaiming the Limits of Their Financial Liability/ Accepting Notice of Injunction; Regarding as Sacred Their Contract Obligations Assumed in Good Faith: Agreeing to Administer for Conservation and to Fairly Apportion in Distributions; and in all Acting as Citizens May Under Common Law Rights of Contract and Federal Enactments Vouchsafed Since the Adoption of the Constitution of the United States of America and the Amendments Thereto, and Hereby Said Trustees Become Sole Owners of an Estate with no Restraints on Powers of Alienation.

(Copyrights, Hulbert Publishing Co., Chicago, Ill., 1935.)

Trade Name of the Board: Lombard Trustees, Ltd.

Executive Offices in: Redlands, California.

Conveyance and Contract of Administration

This Four Part Instrument, made this 3rd day of November, A. D. 1935, is executed as to parties and subject matter, as follows:

Exhibit 3—(Continued)

The parties hereto are hereby designated as Two Groups, namely: 1st. The Grantors who appoint the hereinafter named Trustees, and who convey, grant and deliver unto them property which is in part described herein, but schedules of which are provided and delivered; and, 2nd, the Trustees, who accept the appointment, who accept the property, and who then enter into a contract containing Articles of Administration as between themselves. Witnesseth:

Appointment of Trustees

Charles S. Lombard and Bertha M. Lombard, husband and wife, herein designated as the Grantors, hereby select and appoint Winthrop C. Lombard, Emily F. Lombard, and Norman M. Lombard, Trustees, who, with possible associate and/or successor Trustees in event there be associate and/or successor Trustees, are by virtue of this instrument and for convenience in collective holding and bargaining and in their discretion, to act under and use in their collective and Board capacity the identifying and Trade Name of

Lombard Trustees, Ltd.

The office of Trustee and the Trusteeship hereby established, with all the powers and rights thereto appurtenant, [18] shall and are hereby caused to extend to and rest upon such person or persons as in the discretion and judgment of the Trustees herein appointed, their survivors or survivors from their possible associate and/or successors, or in

Exhibit 3—(Continued)

event there be no survivor then a Court of Equity shall select or appoint and install by such formal or informal method as, in their discretion, is hereinafter this instrument prescribed.

It is intended and hereby determined that the Trustees shall be unrestricted in their ownership, mastery, control, administration and disposition of the Estate, including real and personal property and all rights and privileges thereto incident or appurtenant, except as they themselves shall, by their own choice and in their own judgment and discretion, elect and adopt restrictions, rules and policies of business administration.

Under this instrument the Trustees named, their possible associate and/or successor Trustees in continuity, regardless of personnel, are Joint Tenants. (Not tenants in common) thus holding both their Trusteeship and all Estate properties.

Conveyance

For and in consideration of the objects and purposes herein set forth, the cash sum of One Hundred and no/100 Dollars in hand paid, and other considerations of value, the receipt of which is hereby acknowledged, the said Grantors do hereby make, constitute and appoint the above named and designated Trustees, and their possible associate and/or successor Trustees in continuity, to be and they are hereby made, in fact, absolute and exclusive Owners, in their discretion to act under their designated Trade Name as such or in their

Exhibit 3—(Continued)

individual names collectively, and do hereby sell, assign, transfer, convey and deliver unto said Trustees, and unto their associate and/or successor Trustees in continuity, rights and certain property, with power of sale and rights and powers to convey, mortgage, hypothecate and/or otherwise encumber and/or to convey by trust deeds without hinderance from, submission to, or approval of, beneficiaries hereunder, to constitute the initial Estate, which shall and is hereby made to include certain real and personal property of value, particularly described in schedules and inventories by the Grantors this day delivered to and now held by the said Trustees and with the understanding that no existing liens or obligations attached to any property they may accept or acquire or any part or portion thereof shall be assumed as financial obligations against the Estate Corpus or the Trustees. Except as the Trustees may expressly specify in writing.

Deed

Charles S. Lombard and Bertha M. Lombard, husband and wife, for Ten Dollars ($10.00) and other valuable considerations [19] of a total in value less than One Hundred ($100.00) to them in hand paid, receipt of which is hereby acknowledged, do hereby grant, with power of sale, and power to convey, lease, mortgage, hypothecate, and otherwise encumber by mortgage, deed of trust or other forms of hypothecation and conveyance, unto

Exhibit 3—(Continued)

Winthrop C. Lombard, and Emily F. Lombard, and Norman M. Lombard, Trustees, and unto their possible associate and/or successor Trustees, in continuity, in their discretion to act under, and with their identifying and Trade Name of "Lombard Trustees, Ltd.", and unto their assigns, all of their and each of their rights, title, and interests in the following described real property located in the City of Redlands, County of San Bernardino, State of California, to wit:

(Here was description of real property.)

To have and to hold all and singular, the said premises together with the appurtenances unto said Trustees, their possible associate and/or successor Trustees, in continuity, including all the powers hereinbefore expressed and all those hereafter set forth in the Hulbert Plan Conveyance and Contract of which this is a part, and unto their assigns forever.

Witness our hands and seals this 3rd day of November, 1935.

CHARLES S. LOMBARD
BERTHA M. LOMBARD

(Here was Notary's certificate of acknowledgment.) [20]

Acceptance

The said Trustees, for themselves and possible associate and/or successor Trustees, do hereby accept their appointment and their Offices of Trustees

Exhibit 3—(Continued)

and do hereby accept the above described and referred to real and personal property, duly conveyed and delivered, and agree to conserve the Estate, to handle and barter, manage and administer it and such accretions thereto as may in future accrue, both real and personal, and, in their judgment and discretion to the best of their ability and as they interpret the meanings, purposes and obligations herein expressed, to carry out the spirit, tenor, intentions and purposes herein set forth, subject to the following Articles of Covenant, to wit:

Contract Containing Articles of Administration

Each Trustee hereinbefore designated, for self and for possible associate and/or successor Trustees, hereby covenants and agrees with the other Trustees in Articles of Administration, to wit:

Art. 1. Board of Trustees: The Trustees shall be construed to be the absolute and exclusive owners, in joint tenancy and continuity, of the legal and equitable title to all property, real and personal, in the Estate, having powers including the right to convey and deliver any and/or all such Estate properties at will, and assuming as such Trustees the obligations of administration to which they have voluntarily subscribed.

The Trustees hereunder and as they may change in personnell, as provided herein, shall, in their collective capacity, be construed to be the Board of Trustees. The Board of Trustees shall not at any time exceed Five (5) in number, and the Trustees herein named, associate Trustees they may select

Exhibit 3—(Continued)

and appoint to increase their Board, and possible successor Trustees, from time to time elected or appointed to fill vacancies as they may occur, shall hold their Trusteeship and joint tenancy Ownership of Estate properties in continuity, for the full life or term of this contract, unless removed by death, resignation, court order or a majority vote of their Board members for incompetence, fraud or gross neglect hereunder. Whenever vacancies occur the remaining Trustees may continue alone or they may elect new Trustee or Trustees to fill vacancies, and should the entire Board be vacated a Court of Equity may appoint Trustees. Whenever any such newly elected or appointed Trustee or Trustees shall have formally accepted such election or appointment, the Legal and Equitable Title to the Estate properties, real and personal, shall rest in the new together with the continuing Trustees, in joint tenancy and continuity, and not as tenants in common, and without any further act or conveyance. All resignations, removals, elections and/or appointments pertaining to Board Membership and Property Ownership shall be inscribed in the records of the Board of Trustees.

Art. 2. Board Acts and Meetings: The Trustees may act together informally over their individual signatures or in their Trade Name through duly authorized Officers of their Board. Names of Officers, [21] duties, appointments and authority delegated shall be duly described and inscribed in their Office Records, and the individual Trustees

Exhibit 3—(Continued)

hereby agrees that the Board may authorize and delegate to, by proper resolution, any member or members of the Board of Trustees, the necessary authority to transact any and all business of the Trustees, including that which is necessary or incidental to the execution of deeds, conveyances and other instruments in writing on behalf of the said Trustees.

They may, by unanimous resolution, provide for holding periodical meetings without notice, and special meetings may be called at any time by a majority Or officials giving Five days written Notice to each Trustee. At any such regular or special meeting a majority of all the Trustees then constituting the Board shall constitute a quorum to transact business, their acts to be final unless an absent Trustee shall file a protest in writing with the Board Secretary within five days after receiving notice of such enactment. Such protest can be set aside or overruled by a majority of all the Trustees then constituting the Board of Trustees.

Art. 3. Powers: Being Natural Persons these Trustees, their associate and/or successor Trustees, shall organize themselves into a Board, and may do collectively, in their discretion, any lawful things which citizens may lawfully do in any or all States unless herein limited. (It should be remembered: "Corporations possess only such powers as are granted to them by law, while individuals possess all powers except those prohibited by law.") They may own real estate or personal property in any

Exhibit 3—(Continued)

State without limit, may buy, sell, improve, exchange, assign, convey and deliver, may grant trust deeds and may mortgage or otherwise encumber for obligations; may own stock in or entire charters of corporations, and may engage the Estate funds and properties in any industry or investment in their discretion, hoping thereby to make gain to the Estate. They may delegate authority at will and resolutions of their Board recorded in Minutes of their meetings shall be good and sufficient evidence of their intentions and that their acts are within their powers, discretion and authority to perform.

Art. 4. Trade Name and Seal: The Trustees may and hereby do, without actual or pretended creation of a fictitious name, condition, for convenience in collective holding and bargaining, adopt and use a Trade Name and common Seal, for the purposes of identifying them collectively and as a Board, the style, design and manner of use of each being shown in the final execution of this instrument. The appearance of the Trade Name shall be construed to refer directly to the Natural Persons comprising this Group or Board and authorized to serve as Trustees hereunder. The form used herein in the final execution of this instrument is cited as a good form to follow when Trustees execute contracts and conveyances in their Trade Name, under Seal and in their Board capacity and indicates properly delegated authority. The Trade Name established hereby is a property possessed and owned by the Board Trustees. [22]

Exhibit 3—(Continued)

Art. 5. Administration Rules: The Trustees may regard this instrument as their sufficient guide, supplemented by resolutions of their Board written into their office records to cover contingencies from time to time, or they may adopt formal by-laws or rules of business conduct when expedient, which shall be considered binding upon all Trustees and which may or may not be published.

Art. 6. Board Officials: It is advisable to elect presiding officer and to select and appoint a Board Secretary and/or other officials, to delegate duties and authority, and some Bank may be chosen as a depository, stipulating as to who may sign checks. This Board has selected and authorized its Board President and a Secretary, as shown in the final execution of this instrument, who are subject to changes in personnel in the discretion of the majority of the Trustees from time to time, and as shown in their records, wherein is also shown the degree of authority delegated to each officer in their Board and the location of the Board office and any changes from time to time shall be recorded therein.

Art. 7. Compensation: The Trustees shall fix and pay all compensation to officers, agents and employees in their discretion and may pay to themselves as Trustees, such reasonable compensation as may be determined by a regular act of their Board. Special attention is called to State and Federal regulations in the matter of employing and paying labor, to which these Trustees shall conform.

Exhibit 3—(Continued)

Art. 8. Records: The Trustees shall keep a faithful record of all important transactions, inventories of all Estate properties, account of receipts, and disbursements, name and address of each known beneficiary, indicating therewith comparative ratios or fractions of expectancy; such general records, although private, to be available for examination of interested parties upon Court order or reasonable demand.

Art. 9. Property Holdings: Legal and Equitable Title to all Property in the Estate, real and personal, shall rest in the Trustees—members of the Board of Trustees as they appear in continuity—from time to time, in or identified by their Trade Name or in their individual names collectively, the residue to inure to survivors in their Board, and unaffected by death of any member, with power of sale and power to convey and deliver, and in confident expectation that their administration shall be in good faith.

All income and Estate funds, when collected or paid over to the Trustees, shall be construed to be part of the Estate Corpus from which the Trustees pay obligations, reinvest and/or distribute, in their discretion.

Art. 10. Personal Liability Limitations: These Trustees will follow precedent usual to acts of executors or Trustees of property established with them by will or otherwise, assuming as such Trustees only such obligations attached to the property

Exhibit 3—(Continued)

they acquire as they particularly agree to assume, or resultant from their administration, and then only to the extent and value of the Estate funds and properties, but not personally to jeopardize their personal or separate [23] holdings or property of other Estates they may help to administer.

Art. 11. Publication of Notice: Filing this instrument in the public records of some County named and duly referred to shall be constructive Notice to the World of the specific personal liability limitations stipulated, and all persons, corporations or companies extending credit to, contracting with or having claims aganst the Estate or Trustees as the Owners thereof Must look only to the funds and properties of the Estate for payment or discharge of obligations. To this constructive notice the Trustees should supplement actual notice in writing contracts. The "Ltd." which appears in the Trade Name is a reminder to the "world" of "Limited Liability" of Trustees.

Art. 12. Fiscal Reports: The fiscal year of the Trustees shall end on the last day of each calendar year, at which time they should compile the annual summary of their records, disclosing assets and liabilities, receipts, disbursements and balance of funds carried, comparative profits and loss, with net inventories from which to render lists and financial statements; summaries may be given to each beneficiary of record, read at their meetings or otherwise published for information.

Exhibit 3—(Continued)

Art. 13. Beneficiaries Meetings: The Trustees may, in their discretion, call the beneficiaries to meet annually or at other times, to hear and discuss reports and Forecasts, and while they may adopt resolutions of protest or commendation, no act of the beneficiaries as such shall be mandatory nor to justly question rights of the Trustees to exclusively manage the business affairs and control the Estate funds and properties.

Art. 14. Distributional Accounting System: In the "Hulbert Plan" there is no issue and sale of paper shares under that or any other name or pretense, nor any sale of interests in or fractions of the Estate; merely the expectancy thereunder being divided into fractions, the gross number being predetermined and designated in this contract and in entries in the Register of Beneficiaries which is used by the Board to list beneficiaries; such gross number never to be changed or increased. These fractions allotted As To beneficiaries in the register shall be the guide enabling the Trustees to properly apportion each distribution and the summary thereof shall not be construed to be an index to the intrinsic value of the Estate.

Art. 15. Registration and Dormant Fractions: Expectancy Fractions under this Administration shall at first be allotted in the records of the Board under instructions delivered to the Board by Norman M. Lombard. Should fractions appear dormant thereby, while held dormant they shall not be reckoned with when apportioning in distributions,

Exhibit 3—(Continued)

such being computed solely by or upon the fractions registered As To beneficiaries at time of making each distribution. Dormant fractions, their usefulness being contingent upon possible future convenience, remain subject to the discretion of the Trustees.

Art. 16. Beneficiaries: The Trustees shall duly register every known beneficiary hereunder, devoting to each a separate entry in [24] their special Register of Beneficiaries. A Beneficiary Shall Be Construed to be as One Who Tenants Property, subject to and without affecting the discretion, management and/or absolute ownership of the Trustees in whom legal and equitable title to all Estate properties are Vested.

Death of a beneficiary shall not entitle the heirs or representatives to demand any partition of or interest in or distribution from Estate funds and properties, but the legal heirs may succeed to the expectancy As Of a decedent upon receipt by the Trustees of satisfactory information. The Trustees, thereupon, shall cancel the obsolete entry in such register and make new entry or entries therein for heirs of the deceased as new beneficiaries and permit such new beneficiaries thereafter to be duly considered when making subsequent distributions while they are so registered. Changes in beneficiaries from any cause shall be duly noted by the Trustees, who shall correct their register accordingly. Corrections shall be made in the register by cancelling the obsolete and making new entry or

Exhibit 3—(Continued)

entries of record, and subsequent distributions shall be apportioned according to the changed register.

Art. 17. Distribution of Avails: The Trustees may at any time in their discretion and from any available funds in the Estate, make partial distributions and, ultimately, upon closure of the Estate, shall distribute the entire residual funds; all distributions to be apportioned to beneficiaries of record according to the number of fractions of expectancy appearing as credited to each as compared with the total number of fractions credited as to shall be apportioned according to the changed register.

Art. 18. Duration: Because rules against unlimited succession provoke eventual closure of this contract and Estate Holding, as a safeguard these Trustees adopt the following: This Contract and succession of Trustees and Property Holdings hereunder may continue indefinitely during any lawful term, in the discretion of the Trustees, except that no suspension of title or restraints upon alienation, should either arise hereunder, shall continue beyond a term not to exceed the life of the last surviving subscriber hereto or beneficiary registered under the terms of Article Fifteen herein.

Art. 19. Method of Closure: At time of closure the then acting Board of Trustees shall proceed to liquidate and convert into cash all the then existing assets, pay off all debts or should funds be insufficient, pay all in equal ratio, and shall distribute

Exhibit 3—(Continued)

any Net residue to beneficiaries as provided; when such final distribution shall have been made and a notice to that effect is filed for record wherever this original instrument was previously recorded, announcing final closure, this Estate Holding shall cease and determine and the Trustees shall be automatically discharged; Provided, however, that any dissatisfied creditor may immediately invoke the good offices of a Court of Equity to review the settlement and approve the same or order adjustment of any error, tort or unfairness. [25]

Art. 20. Injunction—Limitations: The Trustees are hereby enjoined to refrain from any actual or pretended issue or sale of capital stock in or of their Estate, such being a corporation prerogative; nor shall they issue or sell shares, equities, units, fractions or undivided interests, legal, beneficial or equitable, in the Estate, either of which would be prejudicial to purity of Estate Holding and in contravention of the fundamentals of the "Hulbert Plan of Property Conservation and Administration" herein employed and adopted.

The Trustees shall not construe Expectancy Fractions, herein provided, to be property of which they are capable of making gifts or sales, nor is it possible to issue, offer for sale, or sell such Expectancy Fractions, they being provided for the convenience of the Board in Accounting and Apportioning in distributions, and do not express or imply property or property rights of any nature.

Art. 21. Amendments: While Conveyance and

Exhibit 3—(Continued)

Delivery of Properties herein described and referred to is Irrevocable, should any part or portion of these articles of covenant, whatsoever, be construed by any Court to be contrary to or in contravention of law, it is the purpose and intention of all parties hereto, that in so far as this Conveyance and Contract is legal it shall continue in full force and effect and the Trustees shall operate thereunder. These Articles of Covenant for formal administration may be altered and/or amended at any time buy the Full Membership of the then acting Board of Trustees jointly executing and attaching an appendix hereto, a copy of which with due reference hereto should be recorded in public records wherever this original instrument was previously recorded.

Art. 22. Taxation—License: These Trustees, being Natural Persons, have the constitutional right to transact business in any and every State free from requirements imposed upon artificial entities, but should the Trustees engage in a licensable occupation, they like other citizens, should and must procure the same license. These Trustees are to pay the usual taxes on their physical properties wherever located and assessed unless exempted, also their annual income tax unless exempted by reason of distributions to beneficiaries, as provided for under Income Tax regulations. Arrangements have been made for the use of the "Hulbert Plan" and all royalty is fully paid.

Exhibit 3—(Continued)

Art. 23. Expectancy: For convenience in Accounting, Registration of Beneficiaries and Apportioning in Distributions, the entire Expectancy under this Administration (not the Estate Properties nor the income therefrom) is hereby divided into Twelve Hundred Fifty Fractions, each to be termed an Expectancy Fraction and expressed by numbers only, such gross number never to be changed or increased, nor shall the figures thereof be construed to be any index to or expression of the intrinsic value of the Estate or Properties whereof it is composed. [26]

In Witness Whereof, the said Grantors, for themselves, their heirs or assigns, have hereunto set their hands and seals in token of Assignment, Sale, Conveyance and complete Delivery of the properties named, referred to and/or described, and assent to all of the provisions expressed in the Articles of Administration as hereinabove set forth.

[Seal of Lombard Trustees, Ltd.]

(Seal) CHARLES S. LOMBARD

(Seal) BERTHA M. LOMBARD

And the said Trustees, for themselves and possible associate and/or successor Trustees have hereunto set their hands and seals in token of acceptance of their Office and Trusteeship as set forth, acceptance of the sale and delivery of the properties involved, and each does hereby assume the obligations and covenants as set forth in the Articles of Administration herein.

Exhibit 3—(Continued)

Done at Redlands, California, the day and year in this instrument above written.

(Seal) WINTHROP C. LOMBARD
(Seal) NORMAN M. LOMBARD
(Seal) EMILY F. LOMBARD

The "Hulbert Plan" instruments are under copyright. Copyrights cover innovations. Infringers and plagiarists, beware of penalties. Mulbert Publishing Co., Chicago, Ill., 1935.

(Here was Notary's certificate of acknowledgment dated November 3, 1935.) [27]

EXHIBIT 4

Fullerton, California,
November 3, 1935

Board of Trustees
Lombard Trustees, Ltd.
162 The Terrace

Redlands, California

Gentlemen: Instructions as to Beneficiaries

Complying with the requirements to name Beneficiaries imposed upon me under the provisions of Article Fifteen (15) of the Conveyance and Contract, and to instruct you in the matter of the Registration thereof under your administration, please be guided by the following instructions:

You shall now please register Beneficiaries and show Fractions of Expectancy allotted as follows:

1. To Charles S. Lombard, when registered, allot Six Hundred (600) Expectancy Fractions. There remains Six Hundred Fifty dormant Expectancy Fractions subject to the terms and conditions of the Conveyance and Contract.

After complying with these instructions, it is my desire that there be no changes made in the register of beneficiaries, except;

1. To equitably register dormant fractions of expectancy whenever the same is justifiable pursuant to the terms of the Conveyance and Contract.

2. When you receive from an originally registered Beneficiary positive written instruction and/or waiver of Expectancy as to any change in his or her registration and/or that of his or her successor; and from a successor registered Beneficiary positive written instructions and/or waiver of Expectancy as to any change in his or her registration only.

3. In the event these instructions lack in clarity, then by the unanimous vote of the Trustees, the Board may order a change that conforms to these instructions.

Respectfully,

NORMAN M. LOMBARD [28]

EXHIBIT 5

Redlands, California,
Feb. 10, 1937.

Board of Trustees,
Lombard Trustees, Ltd.,
162 The Terrace,
Redlands, California.

Re: Request to vacate registration.

Gentlemen:

This is to certify that I, Dr. Charles S. Lombard, am registered as a beneficiary of the administration of your Board of Trustees, identified under the Trade Name of Lombard Trustees, Ltd., and that I do hereby request that your said Board vacate in your Registry all the Expectancy Fractions registered as allotted to me on page 1 of your Registry amounting to 600 Expectancy Fractions, and that the said Expectancy Fractions be, when reregistered, allotted as to the following persons, in the following manner, and to the amounts as follows:

1. To Norman M. Lombard, whose address is 542 West Valley View, Fullerton, California, fifty (50) Expectancy Fractions.

2. To Winthrop C. Lombard, whose address is 162 The Terrace, Redlands, California, fifty (50) Expectancy Fractions.

3. To Emily F. Lombard, whose address is 162 The Terrace. Redlands, California, fifty (50) Expectancy Fractions; and Charles S. Lombard and Bertha M. Lombard, 162 The Terrace, Redlands,

California, as joint tenants, to be named as Contingent Beneficiaries.

4. To Ruth V. Lombard, whose address is 162 The Terrace, Redlands, California, fifty (50) Expectancy Fractions; and Charles S. Lombard and Bertha M. Lombard, 162 The Terrace, Redlands, California, as joint tenants, to be named as Contingent Beneficiaries.

5. To Dorothy M. Pray, whose address is 162 The Terrace, Redlands, California, fifty (50) Expectancy Fractions; and Charles S. Lombard and Bertha M. Lombard, 162 The Terrace, Redlands, California, as joint tenants ,to be named as Contingent Beneficiaries. [29]

6. To Dr. Charles S. Lombard and Bertha M. Lombard, husband and wife, as joint tenants, the remaining three hundred fifty (350) Expectancy Fractions registered as allotted to me on Page 1 of your book, Registry of Beneficiaries.

The number of Expectancy Fractions originally registered as allotted to me was six hundred (600), and after you have approved and registered to the above-named persons as allotted to them the Fractions herein waived, there will remain registered as allotted to me and my wife, as joint tenants, three hundred fifty (350) Expectancy Fractions.

Thanking you kindly, I remain,

Respectfully yours,

CHARLES S. LOMBARD [30]

EXHIBIT 6

Upon motion of Bertha M. Lombard, seconded by Norman M. Lombard, and unanimously carried, the following resolution was adopted:

> Resolved, that this Board of Trustees accepts the waiver of Charles S. Lombard and above presented, and approves the request to register others as beneficiaries under our Estate, identified under the Trade Name of Lombard Trustees, Ltd., and hereby authorizes and instructs the Secretary to register Expectancy Fractions in our Registry of Beneficiaries in accordance with the request contained in the said Request, hereby approving the registrations as of the date of the Request, Feb. 10, 1937;
>
> Further Resolved, That the individual members of this Board of Trustees approve the said registrations and the said waiver by individually signing these minutes at the close of this meeting. [31]

EXHIBIT 7

Amended Declaration of Trust Nature, Contents, and Quotations

The parties were (a) Charles S. Lombard, Bertha M. Lombard and Norman M. Lombard, as trustees, and (b) Charles S. Lombard and Bertha M. Lombard, who were referred to as "donors", and the eight children referred to in paragraph 13 of Stipulation A, all in their individual capacities.

Exhibit 7—(Continued)

The amended declaration referred to in the conveyance and contract dated November 3, 1935, (therein and herein called "First Conveyance and Trust Declaration") and declared:

> "It is now desired to amend said First Conveyance and Trust Declaration to read and provide as hereinafter set forth; and, irrespective of the validity, meaning and effect of said First Conveyance and Trust Declaration, to provide that all property transferred to, or intended to be transferred to, and now held, or believed to be held, by said trustees, shall hereafter be held, used and disposed of upon the trusts and for the purposes hereinafter set forth, without power or right in any person of revocation or further amendment."

In the Amended Declaration it was provided that the Amended Declaration should be and was "substituted for, and shall be and is, a novation of said First Conveyance and Trust Declaration" and "That the provisions of said First Conveyance and Trust Declaration shall be of no further effect and need not hereafter be considered or reverted to for any rights of the parties or the terms of the trust upon which any property is held."

Said Amended Declaration provided in the event of a [32] vacancy in the office of trustee, it should be filled by appointment of the surviving trustees, except that two children there named should be first appointed.

Exhibit 7—(Continued)

Following are excerpts from the Amended Declaration, Articles II and III being set forth in full:

"Article II

Purpose and Irrevocability

Section 1. Purpose. The donors' purpose in establishing said trust was and is to relieve the donors (at least in part) of the responsibility of looking after said property; to provide for the maintenance, comfort and general welfare of said children beneficiaries, and to secure them and their families against privation and want, by sharing said income with said children beneficiaries and ultimately dividing said property or the proceeds from its liquidation and sale among said children beneficiaries, thereby providing each with an estate to be held thereafter and enjoyed in absolute ownership.

Section 2. Trust Irrevocable. Said trust shall be and is made irrevocable, and neither the donors, nor either of them, nor any beneficiary, shall have any right to revoke, modify, alter or change this trust or any provision of this Declaration of Trust."

"Article III

Distribution of Income and Principal and Termination

Section 1. Apportionment of Trust Estate. The trustees shall immediately apportion the trust estate, without being required to make a physical segregation thereof, into shares, and shall allot the same as follows:

Exhibit 7—(Continued)

(a) Two shares, each share equal to one-sixth of the whole estate, one to Charles S. Lombard (one of the donors) and the other to Bertha M. Lombard, his wife;

(b) Eight shares, each equal to one-twelfth of the whole estate, one of said twelfth shares to each of said children beneficiaries.

The person entitled at any time to the income from a share will be referred to herein as "owner" of such share, without regard to the extent of the interest or estate of such person in such share, whether a life estate or other. Whenever any distribution of principal or income is made, the same pro rata distribution shall be made in respect of all shares. [33]

Section 2. Net Income. The term "net income", as herein used, shall be deemed the same as the taxable net income under the then applicable Federal Revenue Act imposing a tax upon incomes, and such net income for any year shall be determined in the same manner in which the taxable net income for that year is determined.

Section 3. Distribution of Net Income. The annual net income from a share shall be distributed annually to the owner or owners of such share, as hereinafter in Section 5 of this Article provided, during the tax year in which such income is received, subject to repayment of advances made, or loss or expense sustained by the trustees, or a trustee, with interest thereon as provided in subdivision (e) of Article IV

Exhibit 7—(Continued)

hereof. The time, or times, of such distributions shall be determined by the trustees, who may, in their discretion, budget the estimated annual net income in order to equalize, so far as practicable, periodical income payments. If actual distribution of the net income during the year of origin be impracticable for any reason, whether inability to compute the same until after the close of the year, lack of available funds, or other cause, the owner of a share, at the close of such year, shall be credited as of the last day of such year with the amount to which he or she is entitled under the foregoing provisions and which has not been actually distributed to him or her, and the amount so credited shall constitute a liability of the trust, payable without interest out of the trust estate as soon as, in the judgment of the trustees, payment can be made. An owner shall be entitled absolutely to receive the amount so credited to him or her. Such right to receive income that has been credited shall be alienable, and it shall not be impaired by the death of such owner, anything to the contrary elsewhere in this Indenture contained.

It is the intent hereof that the net income from a share during any year shall be returned for income tax by its owner, or owners, and shall be included in computing the net income of such owner or owners. If for any reason, under any present or future law, application

Exhibit 7—(Continued)

of the foregoing paragraph providing for crediting such part of said net income as shall not be actually paid would result in making any part of said net income taxable to the trust by depriving the trust or trustees of the right to a deduction equal to, or not less than, the amount so credited, then such provision for crediting the part of said net income not actually paid shall be inoperative, and the annual net income from the respective shares shall under all circumstances be distributed to the respective owners during the year of its origin.

Section 4. Distribution of Principal and Additional Income. The donors desire to authorize and make possible the conversion to cash of all the trust estate, and the dis- [34] tribution of such cash among the beneficiaries. In the opinion of the donors, precipitate liquidation of the properties of the trust is inadvisable, and it is in the interests of the beneficiaries that distributions to them be gradual, giving each an opportunity to school himself by experience in the handling and conservation of property; and finally, if it shall transpire that the children beneficiaries, or any of them, by reason of improvidence or otherwise, are apt to need financial assistance in their advanced years, there will still remain in the trust some property to provide an income sufficient to keep them from actual want.

Accordingly, in addition to the distribution of

Exhibit 7—(Continued)

net income, as provided for in the preceding section, the trustees may, from time to time, from any cash constituting the corpus of the trust estate, distribute such cash to and among the then beneficiaries in the same proportions and relative amounts of net income.

The trustees may also, from time to time, distribute any real or personal property constituting a part of the trust estate to and among the then beneficiaries in proportion to their respective interests. Such distributions shall be known as partial distributions, and the provisions of paragraph (h) of Article IV shall be applicable.

The trustees may also, in order to provide for the reasonable care, education, or comfort of any beneficiary in case of dire need or distress, make partial distributions of principal to any one or more beneficiaries, provided any such partial distribution to a single beneficiary shall be charged against and reduce pro tanto the share of the trust estate of such beneficiary.

Nothing in this section shall be deemed to prevent the trustees from investing or re-investing any moneys at any time in the trust. The discretion of the trustees respecting the distributions in this section authorized shall be absolute and not controlled by the desires of the beneficiaries or by any court or judge.

Section 5. To Whom Distributions Made. All amounts distributed pursuant to the provisions of Sections 3 and 4 of this Article,

Exhibit 7—(Continued)

whether of net income, principal, or other income or tangible property, shall be paid or distributed to the persons and in the proportions, as follows (any person being entitled only to those distributions actually made during his or her life and after the right accrued), to wit:

(a) Distribution upon or in respect of the one-sixth share apportioned to Charles S. Lombard shall be made to the said Charles S. Lombard during his life and thereafter to Bertha M. Lombard, his wife, if living, for the remainder of her life, and thereafter, the same shall be added to and augment equally the then unlapsed shares apportioned to the [35] children beneficiaries.

(b) Distributions upon or in respect of the one-sixth share apportioned to Bertha M. Lombard shall be made to the said Bertha M. Lombard during her life, and thereafter as follows:

Said one-sixth share shall be divided into two shares (without physical segregation) of two-thirds and one-third, respectively. Said two-thirds share (being one-ninth of the entire trust estate) shall be apportioned to Ralph M. Pray, his issue and spouse, and distributions in respect thereof, whether of income or corpus, shall be made to the said Ralph M. Pray, if and while living, and after his death to his from time to time then living lawful issue, upon the principle of representation, and in default of issue at any time to take, then to his spouse, if any,

Exhibit 7—(Continued)

during the remainder of the life of such spouse, and in default of both issue and spouse to take at the time of any distribution, then such one-ninth share so apportioned for Ralph, his issue and wife, shall be deemed to have lapsed and shall be added to and augment equally the then unlapsed shares apportioned to other children beneficiaries.

The-one-third share (being (1/18th of the entire trust estate) shall be added to and augment equally the then unlapsed shares apportioned to the children beneficiaries.

(c) Distribution upon or in respect of a share apportioned for a child beneficiary shall be made to such child beneficiary during his or her life, and from and after the death of a child beneficiary, to his or her, from time to time, living lawful issue, upon the principle of representation, and in default of issue at any time to take, then to the spouse of such deceased child beneficiary, if any, during the remainder of the life of such spouse, and in default of both issue and spouse to take at the time of any distribution, then such share shall be deemed to have lapsed and shall be added to and augment equally the then unlapsed shares apportioned to other children beneficiaries.

Section 6. Final Distribution Upon Termination. Upon termination of the trust, any undistributed principal and income of a share shall go and be distributed to those who at the time

Exhibit 7—(Continued)

of such termination would have been entitled to receive any distribution of net income had a distribution been then made, except that the principal and income of the share of the last survivor of said children beneficiaries (and whose death caused the termination of the trust) shall go and be distributed in the same manner that income from such share would have been distributable immediately after the death of such child beneficiary had the trust been then continuing.

Section 7. Restraint on Alienation. Each beneficiary hereunder is hereby restrained from anticipating, [36] encumbering, alienating, or in any other manner assigning his or her interest or estate in either principal or income, and is without power so to do, nor shall such interest or estate be subject to his or her liabilities or obligations, nor to judgment or other legal process, bankruptcy proceedings, or claims of creditors or others. All income or principal shall be payable and deliverable only and personally to the respective beneficiaries entitled thereto. This trust is intended to provide for the maintenance of each beneficiary entitled to received either income or principal hereunder.

Section 8. Termination of Trust. The trust shall terminate upon the first happening of:

(a) Complete distribution among the beneficiaries of the last of the trust estate (both principal and income); or

Exhibit 7—(Continued)

(b) The death of the last survivor of the donors and the children beneficiaries.

The duration of this trust shall in no event, nor by any possibility, extend beyond the death of those beneficiaries who were in being upon the date of this Indenture."

"Article V

General Provisions

Section 5. Minors and Incompetents. The trustees may make payments of any income or principal payable to or applicable to the use of any minor or incompetent beneficiary by making such payments to the guardian of the person of such minor or incompetent, or to the parent of such minor, or directly to such minor, or may apply the same for the benefit of such minor or incompetent.

Section 6. Adopted Children. The term "child", "children" or "issue" as used herein, shall include legally adopted children.

Section 7. Laws of California Applicable. This Indenture has been executed and this trust has been accepted by the trustees in the State of California, and its validity, construction and all rights under it shall be governed by the laws of said state." [37]

EXHIBIT 8

United States Board of Tax Appeals

LOMBARD TRUSTEES, LTD., a trust, and CHARLES S. LOMBARD, BERTHA M. LOMBARD, and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 104687

George W. Hellyer, Esq.,
for the petitioner.

Frank T. Horner, Esq.,
for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

Harron: Respondent originally determined deficiencies of $5,001.09 and $2,015.10 in petitioner's income tax and excess profits tax, respectively, for the year 1937. Respondent determined that petitioner was an association within the meaning of section 1001 of the Revenue Act of 1936, during the period from February 10 to December 31 of 1937, and, as such, was taxable as a corporation. By an amended answer filed at the hearing, respondent made claim for increases in the deficiencies based upon the contention that petitioner was an association during the

Exhibit 8—(Continued)

entire year of 1937. Respondent now claims that the income tax deficiency is $5,818.66, and that the excess profits tax deficiency is $2,316.28. The main question is whether petitioner is an association, and, as such, taxable as a corporation. The facts have been stipulated.

FINDINGS OF FACT

Petitioner filed a fiduciary return, Form 1041, for the calendar year 1937 with the collector for the sixth district of California. [38]

Charles S. Lombard, hereinafter called Dr. Lombard, and Bertha M. Lombard were married in 1907, and they reside in Redlands, California. Three children were born of this marriage. Each person had been married before and each had children of the previous marriage. The children of Bertha Lombard's first marriage were Ralph Pray, born in 1898, and Dorothy Pray, born in 1900. The children of Dr. Lombard's first marriage were Lillis Stowe, 1883; George Lombard, 1885; Charles S. Lombard, Jr., 1886; Norman Lombard, 1891. The children of Bertha and Charles Lombard were Emily Lombard, 1909; Winthrop Lombard, 1910; Ruth Lombard Paul, 1913. All of the nine children were living on November 3, 1935.

Dr. Lombard was born in 1852. He was 83 years old in 1935. Bertha Lombard was born in 1872. In 1935, she was 63. In 1935, the ages of the above children ranged from 52 to 22 years. In 1935 Dr. Lombard owned real and personal property having a

Exhibit 8—(Continued)

value of about $300,000. The real property included 7 parcels of real estate which were rented for business purposes and a 46-acre orange grove.

In 1935 Dr. Lombard learned of a copyrighted printed plan called the "Hulbert Plan Trust" which was sold by a representative of the publishers in San Bernardino. He purchased one of the printed forms of the plan. On November 3, 1935, Dr. Lombard and Bertha Lombard, as grantors, and Winthrop, Emily, and Norman Lombard, as trustees, executed the "Hulbert Plan Trust". Thereafter, from that date through the taxable year 1937, that agreement was opera- [39] tive and in full force and effect. On November 3, 1935, Dr. Lombard conveyed to the trustees one parcel of business property, and subsequently, during 1935 he conveyed to the trustees several other pieces of business property, including an orange grove. On November 3, 1935, the same day that the agreement was executed, two of the trustees resigned, Emily and Winthrop Lombard. Dr. Lombard and Bertha Lombard became the successor trustees, and they, with Norman Lombard, have acted as trustees ever since then. The conveyance and agreement of November 3, 1935, was recorded on November 14, 1935, in the office of the recorder for San Bernardino County. All of the parties thereto were residents of California, and all of the property conveyed to the trustees under the agreement was located in California.

The "Hulbert Plan" which was executed was a series of legal instruments rather than a trust in-

Exhibit 8—(Continued)

denture. The first instrument is entitled "Conveyance and Contract" and it was executed by Charles S. and Bertha M. Lombard. By this instrument they, as "grantors", appointed three trustees who were to use in their collective capacity the trade name of Lombard Trustees, Ltd. Also, they conveyed to the "trustees", for $100 and other valuable consideration, property described in a "deed" which was made a part of the instrument. Also, they sold, assigned, and conveyed the particular property to the "trustees" as joint tenants and as "the exclusive owners" with power to sell, mortgage, and encumber the property, in their own discretion, "without hindrance from, submission to, or approval of "beneficiaries". It was stated that the "trustees" should be unrestricted in their ownership, control, [40] administration, and disposition of the "estate".

The second instrument was executed by both the "grantors" and the "trustees". It comprises an "Acceptance" by the "trustees" and a "Contract containing Articles of Administration", to which the "trustees" agreed. The "trustees" accepted their appointment and the property conveyed to them, and they agreed to "conserve", "handle and barter", "manage and administer", the property and its accretions.

The "trustees" agreed with each other in "Articles of Administration". The "Articles of Administration" provided that the "trustees" should "be construed to be the absolute and exclusive owners, in joint tenancy and continuity, of the legal and

Exhibit 8—(Continued)

equitable title to all property, real and personal in the Estate." It set forth authorization to the "trustees" to act in their trade name through authorized officers; to be a "Board of Trustees" in their collective capacity; to hold regular and special meetings; and to adopt and use a seal. The "Articles of Administration" set forth the general powers of the "trustees", as follows:

Art. 3. Powers: Being Natural Persons these Trustees, their associate and/or successor Trustees, shall organize themselves into a Board, and may do collectively, in their discretion, any lawful things which citizens may lawfully do in any or all States unless herein limited. (It should be remembered: "Corporations possess only such powers as are granted to them by law, while individuals possess all powers except those prohibited by law.") They may own real estate or personal property in any State without limit, may buy, sell, improve, exchange, assign, convey and deliver, may grant trust deeds and may mortgage or otherwise encumber for obligations; may own stock in or entire charters or corporations, and may engage the Estate funds and properties in any industry or investment in their discretion, hoping thereby to make gain to the Estate. They may delegate authority at will and Resolutions of their Board recorded in Minutes of their meetings shall be good and sufficient evidence of their intentions and that their acts are within their powers, discretion and authority to perform. [41]

Under the "Articles of Administration" the per-

Exhibit 8—(Continued)

sonal liability of the "trustee" was limited, the "trustees" assuming only such obligations attached to the property acquired "as they particularly agree to assume", or which might result from their "administration" of the property, and then "only to the extent and value of the Estate funds and properties, but not personally to jeopardize their "personal property. Also, the "trustees" were required to keep records; to make up financial reports annually; and to allot in the records "expectancy fractions" under instructions to be delivered by Norman Lombard, one of the "trustees". The "trustees" were "enjoined to refrain from any actual or pretended issue or sale of capital stock in or of their Estate, such being a corporation prerogative". Also, the "trustees" were not to issue or sell any equities or beneficial or equitable interests in the estate.

Nowhere in the "Hulbert Plan" which was executed is there a conveyance to trustees for the benefit of cestuis que trust. While the plan contemplated that "expectancy fractions" should be "allotted as to beneficiaries", as a matter of record only, in a "Register", it is provided that such allocation shall be a "guide" to enable the "trustees" to properly "apportion each distribution". The matter of allotting "expectancy fractions" meant no more than making a record of who was entitled to receive distributions, and the proportion each would receive, if, as, and when any distributions were ever made, which was entirely within the discretion of the "trustees".

Exhibit 8—(Continued)

The "Articles of Administration" left to the discretion of [42] the "trustees" the matter of making partial distributions from any available funds in the "Estate", but any distributions were to be made in proportion to the number of "fractions" credited on the books to each "beneficiary". Also, the matter of liquidating the "Estate" and making final distribution of the property to the "beneficiaries", was left within the discretion of the "trustees".

The "Articles of Administration" left to the discretion of the "trustees" the matter of making partial distributions from any available funds in the "Estate", but any distributions were to be made in proportion to the number of "fractions" credited on the books to each "beneficiary". Also, the matter of liquidating the "Estate" and making final distribution of the property to the "beneficiaries", was left within the discretion of the "trustees".

The third instrument which was executed was the direction from Norman Lombard to the "Board of Trustees" to register Charles S. Lombard as a "beneficiary" and to allocate to him 600 "expectancy fractions" out of a total of 1,200, leaving 600 dormant "expectancy fractions."

All of the above described instruments were executed November 3, 1935.

The transfers of property to the "trustees" were irrevocable. The "trustees" were to hold the property until they decided to liquidate, but the longest period was fixed, so as not to violate the rule against perpetuities, by the life of the last surviving sub-

Exhibit 8—(Continued)

scriber to the agreement or registered "beneficiary". [43]

The persons registered as having "expectancy fractions" could be changed. On February 10, 1937, Dr. Lombard requested in writing that the board of trustees of petitioner vacate the registration of the 600 "expectancy fractions" in his name and re-allocate and re-register them. He requested that 350 fractions be re-registered in the name of himself and Bertha Lombard, as joint tenants, and that 50 fractions each be registered in the names of Norman, Winthrop, Emily, and Ruth Lombard, and Dorothy Pray. At a meeting of the board of trustees on March 14, 1937, a resolution was adopted approving the request and the secretary was directed to register the new beneficiaries in accordance with the request. The resolution stated that the board of trustees approved "the registrations as of the date of the Request, February 10, 1937." The registrations were made in the register on March 14, 1937. The re-registrations in the names of the various beneficiaries were made without consideration.

On February 25, 1938, Dr. Lombard and Mrs. Lombard requested the petitioner's board of trustees to vacate the "expectancy fractions" registered in their names, (350), and to re-register and re-allocate the fractions, 200 to themselves as joint tenants, and 50 fractions, each, to George S. Lombard, Charles S. Lombard, Jr., and Lillis S. Stowe. It was requested that the fractions allocated to

Exhibit 8—(Continued)

George S. Lombard should be registered as of July 25, 1937, and that the fractions allocated to Charles S. Lombard, Jr., should be registered as of January 29, 1938. At a meeting of the trustees on February 26, 1938, a [44] *a* resolution was adopted approving the request. The reregistrations were made in accordance with the request.

No other re-allocations and reregistrations of "beneficial interests" have been made.

Dr. Lombard filed a gift tax return for 1935. In it he reported transfers of property to Lombard Trustees, Ltd., and he placed values thereon as follows:

1. November 3, 1935, real property, Redlands	$5,610.00
2. November 19, 1935, real property, lot, Redlands	24,190.00
3. November 19, 1935, real property, lot and building, Redlands	17,540.00
4. November 19, 1935, real property, lots	13,830.00
5. November 19, 1935, real property, lot and filling station Riverside	810.00
6. November 19, 1935, real property, 4 lots, San Diego	2,500.00
7. November 19, 1935, real property, orange grove Redlands	2,000.00
8. December 31, 1935, stocks	64,587.93
	$131,067.93

Several of the pieces of real estate conveyed to petitioner by Dr. Lombard are business properties, stores and offices, which are rented. In the taxable year 1937 these business properties and the orange grove produced income which was reported by

Exhibit 8—(Continued)

petitioner on Form 1041, "fiduciary income tax return."

During the taxable year, 1937, petitioner received income from the property it held from rents, dividends, and the operation of the orange grove as follows:

Dividends	$4,234.95
Interest on bank deposits	200.00
Rents—net—after repairs, depreciation and expenses	14,230.65
Receipts from orange grove—net—proceeds from sale of oranges	10,048.12
Total	$28,713.72

[45]

In the fiduciary income tax return filed by petitioner, it reported net income, after deductions, in the amount of $23,014.05. Among the deductions taken were the following: Interest paid on note for $39,000, $2,025.52; taxes—city and county taxes on property, $155.92, state income tax, $137.50, social security tax, $14.94, total, $308.36; miscellaneous expenses, $425.68; salaries, $2,904.84.

Petitioner attached to the fiduciary income tax return, Form 1040 F. "Schedule of Farm Income and Expenses". On this return petitioner reported $24,634.95 from the sale of oranges and $494.66 from receipts from "water and pipeline" and miscellaneous, and total expenses of $15,081.49, leaving net receipts of $10,048.12.

The expenses of operating the orange grove included wages, fertilizers, and spraying materials,

Exhibit 8—(Continued)

fuel, taxes, insurance, water rent, smudge oil, tractoring, telephone, and repairs.

Petitioner reported in the fiduciary income tax return as the distributable income of the registered beneficiaries, total net income, as follows:

Norma Lombard	$1,917.84
Emily Lombard	1,917.84
Ruth Lombard	1,917.84
Winthrop Lombard	1,917.84
George Lombard	1,917.84
Charles S. Lombard	5,753.51
Bertha Lombard	5,753.50
Dorothy Pray	1,917.84
	$23,014.05

[46]

The oranges grown were part Valencia and part navel oranges. In the vicinity of Redlands, navel oranges mature so as to be marketable in late November or early December, and are generally picked and marketed during the months of December, January, February, March and April. On January 1, 1937, there was on the orchard a matured crop of navel oranges. On February 23, 1937, the navel crop was sold for the sum of $2.80 per hundred pounds on the trees, the buyer to pick and haul, with the picking to commence March 1, 1937, and to be completed by April 10, 1937. The crop was picked by the buyer between March 1, 1937, and April 13, 1937. No expense was incurred or paid by the trustees or petitioner in connection with the crop after its sale on February 23, 1937. The

Exhibit 8—(Continued)

trustees received for the crop the following amounts: On February 23, 1937, $10,000; on March 10, 1937, $5,000; on April 15, 1937, $1,868.96; total, $16,868.96. In stating and determining the net income for different periods of 1937 above, each payment received for the navels was credited to gross income for the period in which received.

Subsequent to March 14, 1937, the only sales made by the trustees apart from ranch products were the following: (a) On March 24, 1937, sold stock of American Trust Company costing $5,189.44 for $5,145.35 and bought stock of Baltimore American Insurance Company for $5,133.75; (b) on July 13, 1938, sold bonds of Kansas City School for $5,520.75.

On June 14, 1940, prior to the mailing of the notice of deficiency herein, petitioner mailed to the collector of internal [47] revenue, Los Angeles, a duly executed capital stock tax return, on form 707, for the year ending June 30, 1937, wherein the value of petitioner's "capital stock" was declared to be $150,000. Petitioner enclosed a check in the total amount of $213.75 for the payment of the capital stock tax, $150; the 25 percent penalty for delinquency, $37.50; and interest from August 1, 1937, $26.25. The amount so paid has never been refunded to petitioner, and no claim for refund has been filed or made.

The petitioner's adjusted net income for the entire calendar year 1937 was $22,902.04, of which $4,234.95 was from dividends.

Exhibit 8—(Continued)

A trust at law was not created by Dr. Lombard by his execution on November 3, 1935, of the several instruments constituting the Hulbert Plan, and petitioner was not a trust prior to or during the taxable year. Rather, some type of enterprise in the nature of a family corporation was created under the Hulbert Plan. Dr. Lombard transferred absolute title, legal and equitable, to various properties, real and personal, to himself, Norman Lombard, and Bertha Lombard, as joint tenants. They, and they only, were the equitable as well as the legal owners of the property. They and their successors, only, could determine who should eventually receive distribution of the property upon liquidation of the enterprise.

During the taxable year, 1937, petitioner was an association within the meaning of section 1001 of the Revenue Act of 1936. [48]

OPINION

The main question is whether petitioner was an association during all of 1937, and, as such, taxable as a corporation. During 1937 the "Hulbert Plan" which was executed in November of 1935 was in effect, and no supplemental agreement or amendment thereto was in existence. Accordingly, the question must be determined upon consideration of the terms of the 1935 agreement. Also, the burden of proof is upon petitioner to show that it was not engaged in business enterprises for profit, or that it did no more than conserve trust property with

Exhibit 8—(Continued)

the necessary incidental activities of a trustee. Petitioner has introduced very little direct evidence relating to its activities with respect to the various properties it held. However, the income tax return filed by petitioner does set forth much which is indicative of petitioner's activities.

Respondent has determined that petitioner is an association, taxable as a corporation. Section 13 of the Revenue Act of 1936 levies a tax upon the net income of corporations, and section 1001 (a) (2) provides that the term "corporations" includes "associations."

The Supreme Court, in Morrissey v. Commissioner, 296 U. S. 344, has set forth many tests to apply in the determination of the question. The Court pointed out the characteristics which distinguish a "business trust" from the traditional type of trust. In Porter Property Trustees, Ltd., 42 B. T. A. 681 (on appeal to Circuit Court of Appeals for the Ninth Circuit), we had to analyze the provisions of an agreement under which Porter Property Trustees, Ltd. [49] had been created. It happens that there, as here, the so-called "Hulbert Plan" was the agreement. Applying the criteria of the Morrissey case, we concluded that the facts indicated "a family corporation which it was thought could be operated as a trust under the so-called Hulbert Plan, without paying corporate rates," p. 690, and we held that the petitioner was an association, and therefore, that it was taxable as a corporation. Respondent, in this case, relies

Exhibit 8—(Continued)

upon the conclusions reached in Porter Property Trustees, Ltd. The situation here is much the same as in the cited case. It is not material that there is absent in this case a step which preceded the "trust" arrangement in the Porter case, namely, ownership of the property by a corporation before the execution of the "trust" agreement. The Porter case is followed here in all that was said of the application of the tests set forth in the Morrissey case, which need not be repeated.

However, each case should be considered upon its own facts, and it appears to be necessary to discuss here the terms of the agreement under which petitioner acted so as to point out why, again, we must hold that such terms as the "Hulbert Plan" is made of can lead to no other conclusion than that it creates an association rather than the traditional trust. In this respect, the consent about the definition of "association" made by the Supreme Court in Hecht v. Malley, 265 U. S. 144, 44 Sup. Ct. 462, 467, is pertinent:

> The word "association" appears to be used in the Act in its ordinary meaning. It has been defined as a term 'used throughout the United States to signify a body of persons united without a charter, but upon the method and forms used by incorporated bodies for the prosecution of some common enterprise'. [50]

It is rudimentary that every trust must have a cestui que trust, a definite or ascertainable beneficiary. Also, in most jurisdictions, the rights of

Exhibit 8—(Continued)

the cestui que trust are such that it has not only a personal right against the trustee to have the trust carried out, but also an equitable ownership of the trust res, or a "present equitable estate". Restatement of the Law of Trusts, secs. 112, 199; 17 Col. Law Rev. 269; Scott, The Nature of the Rights of Cestui Que Trust; Title Insurance & Trust Co., v. Duffill, 191 Cal. 629. Also, trustees are fiduciaries. In this case, Dr. Lombard conveyed the complete legal and equitable title to property to persons called "trustees" in exchange for all the issued fractional units in petitioner which were 600 in number. There was no conveyance to trustees in trust for named or personal beneficiaries as is typical of the traditional trust. The "beneficiaries" were only impersonal registrants holding units of interests in earnings and proceeds. The so-called trustees were to manage the property, and ultimately distribute the proceeds from liquidation, for such persons as might, from time to time, be the registered holders of fractional units, as shown on a register. The registrants could change from time to time through reregistration of units. And the register of such persons was to be only a "guide" to enable the petitioner to ratably apportion such distributions as it, in its discretion, decided to make (Article 14 of the "Hulbert Plan"). See Solomon v. Commissioner, 89 Fed. (2d) 569, where a business trust was held to be an association and where in the trust there were no named personal beneficiaries. Re-

Exhibit 8—(Continued)

peatedly in the executed "Hulbert Plan" it is stated that petitioner was the sole owner of the "estate" with no [51] restraints on powers of alienation. Thus at the outset there is the very obvious lack of the elementary form of a trust in the agreements under which petitioner functioned.

An association implies associates. A trust implies present disposition of property to one for the benefit of another, not an undertaking to make a disposition in the future. Restatement of the Law of Trusts, pp. 62, 63. Notice to and acceptance by the trustee and the beneficiary is not essential. Evidence in this case which negatives the creation of a trust and which indicates an association is found in the fact that Dr. Lombard set about to obtain the consent of eight of the children to come into the plan. He did not obtain their consent at first and for that reason the entire 600 "issued" units of interests were registered in his name. The reregistrations of the 600 units to register interests in various children which were made on March 14, 1937, and February 26, 1938, were made pursuant to the consent of the eight children at or about such dates to come into the plan. Thus it appears that Dr. Lombard, his wife, and his eight children, became associates, Dr. Lombard contributing all of the property and the children sharing in the fruits of the enterprise, one of the children acting with Dr. Lombard in the management. See Solomon v. Commissioner, supra. There

Exhibit 8—(Continued)

was no transfer of property by Dr. Lombard to a trustee in trust for named persons as a means of equitably distributing a legacy or donation to them. Of Blair v. Wilson Syndicate Trust, 39 Fed. (2d) 43, 46, where the court pointed out a distinction between an association and a trust as lying in a voluntary association of individuals for convenience and profit as opposed to a method of distributing a [52] donation. It is not material that the eight children did not contribute property. Roberts-Solomon Trust Estate, 34 B. T. A. 723, 725, affd. 89 Fed. (2d) 569.

Purpose is important, if not determinative. Part of petitioner's burden of proof goes to showing what was the purpose in executing the agreement under which petitioner functions. Petitioner asks us to go outside the terms of the agreement which was in effect in the taxable year for the purpose. This we cannot do. Helvering v. Coleman-Gilbert Associates, 296 U. S. 369; Sup. Ct. 285, 287. Dr. Lombard executed another agreement on September 30, 1938, entitled "Declaration of Trust" to take the place of the "Hulbert Plan" executed in 1935. That agreement follows more closely the form of a traditional trust, but it was not in effect in the taxable year. Nowhere in the agreement which was in effect in 1937 is there any statement of purpose to place property in trust for the benefit of named persons to provide them with a definite income, and with property, or proceeds from liquidation thereof, upon the death of Dr. Lombard

Exhibit 8—(Continued)

or at any ascertainable time. Cf. Living Funded Trust of Harry E. Lyman, 36 B. T. A. 161. We must look to the terms of the "Hulbert Plan" which was executed rather than speculate as to what Dr. Lombard's state of mind may have been. The general purpose stated in the "Plan", the broad powers given to petitioner, the facts as to petitioner's activities all lead to the conclusion, in the absence of contradictory evidence, that the purpose was to provide a method of putting all of Dr. Lombard's business properties under centralized and continuous management for realizing profits and distributing them to all who came into the plan. Cf. United States v. Davidson, [53] 115 Fed. (2d) 799, 800, where, in the trust instrument in that case, it was stated that the purpose was not to form an association, but to convert trust property into money and distribute the proceeds to named beneficiaries.

From the limited facts on the point, it appears that petitioner is a business enterprise. It rents several properties and manages the buildings. The net annual rents, without considering depreciation, amount to $15,751.10. The properties include four "mercantile buildings", a store, and a service station with equipment. Petitioner grows oranges, which is certainly an agricultural and business enterprise. In this activity petitioner expended for "farm expenses" over $14,000. In 1937 the orange crop was sold for a gross amount of $24,635. All of petitioner's business activities were to be carried

Exhibit 8—(Continued)

on for a long period of time, not for the benefit of any named persons, in the 1935 agreement, but for the benefit of registrants, whoever they might be, from time to time. Thus it appears that petitioner, as a group of trustees, was not merely a "trustee" for collecting funds and paying them over, but rather petitioner was more like a board of directors of a corporation appointed to carry on business enterprises. Hecht v. Malley, supra. It is concluded that petitioner was a business trust in the taxable year. In form petitioner resembles a "Massachusetts trust", the only dissimilarity being that no paper certificates were issued, which is immaterial since a register was kept.[1] [54]

In other respects, petitioner resembles a corporation form of enterprise for the medium of conducting business and sharing in the gains. The "Articles of Administration" resemble both a charter and bylaws. The "trustees" resemble both the officers and directors of a corporation. The exclusive control over distributions reposed in the "trustees", both as to the amount and the time of distributions, is

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[1]In Hecht v. Malley, 44 Sup. Ct. 462,463, it was pointed out that a "Massachusetts trust" may be a trust of a partnership accoring to the way in which the trustees are to conduct affairs committed to them. If they are principals free from control by the holders of interests in the management of property, a trust is created. If the holders of interests are associated together in control of the property and the trustees are mere managing agents, a partnership relation between the holders of interests is created.

Exhibit 8—(Continued)

like the power of the directors of a corporation to declare dividends. The "register" of "beneficiaries" resembles a record of stock ownership. The proviso that the register is a "guide" for making proportional distributions fixed distributions in accordance with the number of units allocated to each registrant, which is like distributing earnings in accordance with stock ownership.

It is held that petitioner is an association taxable as a corporation, and that such was its status throughout 1937. Upon this holding it is not necessary to consider any question relating to the inclusion in petitioner's income of proceeds from the sale of the crop of oranges received at various dates in 1937.

Petitioner filed a late capital stock tax return for the period ending June 30, 1937, together with a check for the amount of tax, interest, and penalty due, on June 15, 1940. Respondent mailed the notice of deficiency on the same day. Petitioner is entitled to the credit claimed for the declared value of its capital stock in determining the excess profits tax. Del Mar Addition v. Commissioner, [55] 113 Fed. (2d) 410; Jordon Creek Placers, 43 B.T.A. 131; Huron River Syndicate, 44 B.T.A. 859. Respondent does not contend otherwise. Accordingly, the deficiency in the excess profits tax must be recomputed under Rule 50. Under the holding made, there is a deficiency in income tax in the amount of $5,818.66.

Decision will be entered under Rule 50

Enter:

Entered May 6 1942 [56]

EXHIBIT 9

United States Board of Tax Appeals
Washington

Docket No. 104687

LOMBARD TRUSTEES, LTD., a Trust and CHARLES S. LOMBARD, BERTHA M. LOMBARD and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion entered May 6, 1942, the respondent herein having on June 4, 1942, filed a recomputation of tax and the petitioner having on June 17, 1942, filed an acquiescence therein, now therefore, it is

Ordered and Decided: That there are deficiencies in income tax and excess profits tax for the calendar year 1937 in the respective amounts of $5,818.66 and $258.14.

(Signed) MARION J. HARRON
[Seal] Member.

Enter:

Entered Jun 19 1942 [57]

EXHIBIT 10

United States Circuit Court of Appeals
for the Ninth Circuit

B T A Docket No. 104687

LOMBARD TRUSTEES, LTD., a Trust, and CHARLES S. LOMBARD, BERTHA M. LOMBARD and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DECISION OF BOARD OF TAX APPEALS

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

The petition of the above named petitioner respectfully shows:

1. This is a proceeding for review by the United States Circuit Court of Appeals for the Ninth Circuit of a decision of the United States Board of Tax Appeals, entered on June 19, 1942, redetermining deficiencies in income tax and excess profits tax for the calendar year of 1937 in the respective amounts of $5,818.66 and $258.14, all of which was in dispute.

2. Petitioner filed an income tax return for said year of 1937 with the Collector of Internal Revenue

at Los Angeles, California. The office of said Collector is within the Ninth Circuit.

3. The nature of the controversy before the Board of Tax Appeals was the determination of income and excess profits [58] taxes of petitioner for the year of 1937.

Petitioner claimed before said Board of Tax Appeals, and now claims:

(a) That at all times during 1937 petitioner was a trust and was taxable as a trust;

(b) That, assuming petitioner was an association taxable as a corporation, petitioner did not become such association until March 14, 1937, and was taxable as a corporation only on income for the period March 14, 1937 to December 31, 1937, which income amounted to and was the sum of $6,613.43.

Respondent claimed before said Board of Tax Appeals that at all times during 1937 Petitioner was an association taxable as a corporation, and as such was taxable on income for the entire year, amounting to $22,902.04.

The Board of Tax Appeals held petitioner was an association taxable as a corporation, and was such an association at all times during 1937.

Wherefore, petitioner prays this Honorable Court to review the action of the Board of Tax Appeals in this cause and reverse the decision of said Board and direct the entry of the decision of said Board in favor of petitioner, determining that petitioner was not an association taxable as a corporation during the year 1937, or in any event, was not such an asso-

ciation prior [59] to March 14, 1937, and determining petitioner's tax liability accordingly.

GEO. W. HELLYER
JOHN B. SURR
Attorneys for Petitioner
204 Citizens National Bank Building
San Bernardino, California

[Endorsed]: Filed Sept. 8, 1942.

[Endorsed]: U.S.B.T.A. Filed Oct. 6, 1942. [60]

[Endorsed]: No. 10289. United States Circuit Court of Appeals for the Ninth Circuit. Lombard Trustees, Ltd., a Trust, and Charles S. Lombard, Bertha M. Lombard and Norman M. Lombard Trustees thereof, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed October 19, 1942.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

No. 10289

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

LOMBARD TRUSTEES, LTD., a Trust, and CHARLES S. LOMBARD, BERTHA M. LOMBARD and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

UPON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES.

GEO. W. HELLYER,
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204 Citizens Natl. Bank Bldg., San Bernardino, Cal.,
Attorneys for Petitioner.

Parker & Baird Company, Law Printers, Los Angeles

TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

Cases. PAGE

Miscellaneous.

Statutes.

No. 10289

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

LOMBARD TRUSTEES, LTD., a Trust, and CHARLES S. LOMBARD, BERTHA M. LOMBARD and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

Record on Appeal.

This proceeding is to review a decision of the Tax Court of the United States, formerly called the "United States Board of Tax Appeals" and hereinafter called "Board". The record on appeal consists of an agreed statement of the case under rule 76 of the Rules of Civil Procedure, which statement is printed in full in the transcript of the record. The latter is herein referred to by the letter "T", and its pages by their numbers. The only previous opinion is the memorandum opinion of the Board, which, with the findings, is printed in full in the transcript. [T 53-73.]

Jurisdiction.

This appeal involves income and excess profits taxes for the year 1937 and is taken from a decision of the Board entered June 19, 1942. [T 74.] Petitioner's income tax return for 1937 was filed with the Collector of Internal Revenue at Los Angeles. The office of said Collector is within the Ninth Circuit. The case is brought to this Court by petition for review filed September 8, 1942 [T 75-77], under the provisions of Sections 1141-1142 of the Internal Revenue Code.

Questions Presented.

(a) Whether a trust of which the grantor and creator is the sole beneficiary may be an "association" taxable as a corporation;

(b) When a written declaration of trust is silent as to purpose or is consistent with different purposes, whether evidence of the purpose of the grantor in creating the trust is relevant.

Statement of the Case.

On November 3, 1935, at Redlands, California, Charles S. Lombard (hereinafter called "Dr. Lombard"), then aged 83 years, his wife (hereinafter called "Mrs. Lombard") and three of their children executed instruments hereinafter called "trust declaration" whereby the legal title of certain property theretofore owned by Dr. Lombard, was vested in Dr. Lombard, Mrs. Lombard and

Norman M. Lombard, as trustees of an express trust. Said three persons, as such trustees, are sometimes herein referred to as "petitioner", and sometimes as "trustees". Subsequently, Dr. Lombard caused the legal title of other property owned by him to be vested in said trustees. Dr. Lombard was the sole beneficiary under said trust and held the entire beneficial interest from the time of its creation on November 3, 1935, until March 14, 1937. On the last mentioned date, a part of the beneficial interest was transferred to and became vested in Dr. Lombard's wife and five of their children, and on February 25, 1938, another part of the beneficial interest was transferred to and became vested in three others of their children, so that from and after February 25, 1938, the beneficial interest was held by Dr. Lombard, Mrs. Lombard and eight of their children, three being of their marriage, four of Dr. Lombard's previous marriage, and one of Mrs. Lombard's previous marriage. [T 7-11.] The instrument resulting in the first change in the ownership of the beneficial interest was dated February 10, 1937. [T 40.]

The trustees filed a fiduciary return of income for the year of 1937. On June 15, 1940, respondent gave notice of a deficiency in 1937 taxes, stating and holding that petitioner was taxable as an association for the period February 10, 1937 to December 31, 1937, and that Dr. Lombard as grantor and creator of the trust was taxable for the income prior to February 10, 1937. Respondent apportioned the total income for 1937 on a daily basis to

February 10, 1937 between Dr. Lombard and petitioner and determined there was a deficiency in petitioner's taxes. [T 1, 2.]

The trustees petitioned the Board for a redetermination. The cause was heard at Los Angeles on June 10, 1941. At the hearing, respondent filed an amended answer alleging petitioner was an association taxable as a corporation during all of 1937. At such hearing the case was submitted upon said fiduciary return for 1937, a gift tax return of Dr. Lombard for 1935, and two written stipulations that have been incorporated in the record on appeal. [T. 2, 3.]

The Board determined petitioner was an association taxable as a corporation and that petitioner was such association during all of 1937. [T 73.]

ARGUMENT.

Assuming the Trust Was an Association Taxable as a Corporation During Some Part of 1937, It Did Not Become Such Until Others Became Associated With Dr. Lombard as Beneficiaries, and No Persons Became Associated With Dr. Lombard so as to Form Such Association Until March 14, 1937.

Dr. Lombard bought the trust declaration from a person engaged in real estate and insurance. It was a copyrighted, stereotyped form known as the "Hulbert Plan trust". [T 17, 18.] It was the identical, legal monstrosity that was considered by this Court in *Porter Property Trustees, Ltd. v. Commissioner,* where in an opinion rendered July 29, 1942, Porter Property Trustees, Ltd. was held to be an association taxable as a corporation. We have no quarrel with that decision.

At the time of the establishment of the trust on November 3, 1935, 600 "expectancy fractions" were registered in the name of Dr. Lombard. [T 10, p 8.] At a meeting of the trustees held March 14, 1937, they received an instrument dated February 10, 1937, signed by Dr. Lombard, entitled "request to vacate registration". [T 10, p 9.] This was a request to change the registration of the 600 "expectancy fractions" so as to show 350 in Dr. and Mrs. Lombard as joint tenants and 50 in each of five children. [T 40, 41.] On March 14, 1937, the trustees adopted a resolution [T 10] approving the request and instructing the Secretary to register the "expectancy fractions" pursuant to the request, the resolution concluding "hereby approving the registration as of the date of the Request, Feb. 10, 1937". [T 42.] The stipulation of

facts recited that "pursuant to the request and resolution said 600 'expectancy fractions' were, on March 14, 1937, registered on the records of the trustees in the manner provided in said request". [T 11, p 10.]

No case has been found or was called to the attention of the Board in which it was held or intimated that a trust of which the grantor and creator was the sole beneficiary constituted an association. On the contrary, every statement from the Supreme Court down establishes that at least two beneficiaries are essential to constitute an association. Further, while a trust may be an association whether it has one or several trustees, no court ever heretofore held or intimated that the plurality required to constitute an association might be satisfied by two or more trustees. The decision of the Board involves and, we respectfully allege, violates a most important legal principle.

The case also involves substantial taxes. It may not be disposed of by application of the principle *de minimis non curat lex*.

There have been two major freezes in Southern California affecting the citrus industry, one in 1913 and the other in January of 1937. During 1936 and thereafter, the trustees had title to a 46-acre orange grove at Redlands. On January 1, 1937, there was on this grove a matured navel crop. [T 13, 14.] It is evident this crop was saved during the freeze for, on February 23, 1937, the crop was sold on the trees for the fabulous price of $2.80 per hundred pounds, the buyer to pick and haul, with the picking to commence March 10, 1937 and be fully completed by April 10, 1937. No expenses were incurred or paid by the trustees after the sale of the crop on February 23, 1937. The trustees received for the crop $16,868.96 of

which $15,000 was received prior to March 14, 1937. [T 13-15.]

The entire amount received for this fruit represented income accrued prior to March 14, 1937. It is not impossible Dr. Lombard had ascertained that respondent deemed all income of the trust was to be returned by and taxed to him while he was the sole beneficiary, and, therefore, on March 14, 1937, he transferred a portion of the beneficial interest to Mrs. Lombard and the children, intending the gift and transfer to be retroactive to a date prior to the sale of the fruit (as he might lawfully do), but erroneously believed the income from the fruit would then be returnable by all of the beneficiaries. Such return was in fact made. [T 63.] If Dr. Lombard was liable to return and pay the tax on the 1936 income of the trustees (as he in fact was), he was also liable to return and pay the tax on all income of the trustees up to March 14, 1937, which included the $16,868.96 from the sale of the navel crop. He could not relieve himself of this liability by a gift of the income.

Assuming the trust became an association on March 14, 1937, the net income for the period March 14, 1937 to December 31, 1937 (excluding orange proceeds of $1.-868.96) amounted to $6,613.43 [T 13], and the tax at corporate rates was:

Normal tax $355.79 and undistributed profits tax $531.50, making a total of $887.29.

The Board determined the tax on petitioner to be:

Normal tax	$2,149.30
Surtax on undistributed profits	3,669.36
Excess profits tax	258.14
Total	$6,076.80

Therefore, the point under discussion involves federal taxes for 1937 amounting to $5,189.51. Nor is that all, for the Franchise Tax Commissioner of California is awaiting the decision in this case to determine whether there is a liability for franchise tax, and if so, whether that liability attached to income of the trust from November 3, 1935 on, or only on income after March 14, 1937.

Nor should it be thought a decision favorable to petitioner will result in the 1937 income escaping taxation. As noted, the entire income for 1937 was reported as taxable to Dr. Lombard, Mrs. Lombard and six children. [T 63.] . It is proper to assume that each included as a part of his income for 1937 the amount reported by the trustees as returnable by him. The time for filing refund claims expired three years after March 15, 1938. The decision of the Board was rendered after the time for filing refund claims had expired. Should it be held that petitioner was an association during all of 1937, then the 1937 income will have been taxed twice, one at rates applicable to individuals and again at corporate rates, including therein a very harsh undistributed profits tax alone amounting to $3,669.36. Should it be held that the trust became an association on March 14, 1937, only a part of the 1937 income will be doubly taxed. We are not asking for, nor do we expect, sympathy. At the same time, we do not expect anyone to assert, imply or think that the trustees have unclean hands and are not entitled to a decision solely on the facts and the law.

(Unless otherwise noted, all emphasis has been added by the writers.)

In the leading case of *Morrissey v. Commissioner*, 296 U. S. 344, the laws and decisions pertaining to the term "association" were extensively reviewed, and it was said:

> " 'Association' implies *associates*. It implies the entering into a *joint enterprise*, and, as the applicable regulation imports, an enterprise for the transaction of business."

In *Helvering v. Coleman-Gilbert Associates*, 296 U. S. 369, the same court declared:

> "A *few* persons, as well as many, may form an association to conduct a business for *their common* benefit."

In *Garfield Building Site Trust v. Commissioner* (1940), 115 Fed. (2d) 481, the following definition was given:

> "The term 'association' does not have in law the fixed meaning accorded to 'partnership' or 'corporation' but in its business sense is used to indicate a *collection of persons* who have united or joined together for some business purpose. It may be defined as a *body of persons* acting together without a charter but using the methods and forms of corporate bodies in the prosecution of some business enterprise for profit."

See also the numerous definitions of association in *Paul and Mertens Law of Federal Income Taxation*, Vol. 4, Sec. 35.10, 1934 ed.

From every definition and case, it is clear that two or more must be united or associated in a common purpose. In some instances the trust form is used to give effect to the purpose. Assume there was an association not in

trust form that functioned through a committee, or a board of managers. Such managing committee or board would not constitute the "associates" or the "few persons" or the "collection of persons" or the "body of persons" referred to in the foregoing definitions. Those beneficially interested (in most associations called "members") would be the "associates" or "few persons" or "collection of persons" or "body of persons". Those for whose benefit the enterprise is conducted are the "associates". In the case of an association in trust form, it is the beneficiaries of the trust or *cestuis que trustent* who are the associates. The trustee or trustees, if the association be in trust form, or the committee or board of managers, may or may not be beneficially interested as members.

The foregoing statements are distinctly recognized by the regulations which were the same in 1937 as now.

Section 19.3797 of Regulations 103, provides:

> "A trust may be classed as a trust or as an association. . . . It (association) includes any *organization*, created for the transaction of designated affairs . . . and the affairs of which, like corporate affairs, are conducted by a *single individual*, a *committee*, a *board* or *some other group*, acting in a representative capacity. . . . As distinguished from the ordinary trust described in the preceding paragraph there is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of *beneficiaries*. . . . The nature and purpose of a *cooperative undertaking* will differentiate it from an ordinary trust. . . . If a trust is an undertaking or arrangement conducted for income or

> profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the *beneficiaries* are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Internal Revenue Code as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association."

Note, please, the Commissioner declares "the *beneficiaries* are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association". In other words, those who are beneficiaries of the trust are the members of the association.

In *McKean v. Scofield* (1940), 108 F. (2d) 764, a father and four children owned oil and other properties as cotenants. On the same day, each of the five, by separate deed, conveyed to the father and two sons, as trustees, his interest in the oil properties, and by another deed his interest in the other properties, making ten conveyances and ten trusts. Each trust was created for the benefit of the grantor and his descendants. The trusts were substantially identical and the trustees had powers of full management and control, sale, lease, investment, reinvestment and partition. The trusts created by the children were to terminate five years after the death of the father. In administering the trusts, the trustees kept one bank account and one set of books. A tax was assessed on the

theory that all trusts constituted an association. The Circuit Court for the 5th circuit held there was nothing in law or the trust declarations that bound the trusts together, hence there was no association. The Court said:

> "It may be conceded that these trustees are engaged in business, so that if the owners in common had conveyed their interests into one trust, or otherwise formed a company to own and manage them, a business association might have resulted. They may have thought and purposed that a harmonious cooperation would be achieved by selecting the same trustees and giving them the same powers. But we think that so long as each owner kept his interest separate, and for the use of his own chosen beneficiaries, with no compulsory cooperation with the others, there arose among the several trusts nothing so like a corporation that it could be held an association taxable as a corporation."

There, the Circuit Court cited approvingly *U. S. Trust Co. v. Commissioner,* 296 U. S. 481, which was decided less than a month after the decisions in the famed *Morrissey* and companion cases were handed down. In the *U. S. Trust Company* case it was held that, by amendment, a trust had been converted into three trusts, each of which was taxable separately. It is interesting to note that in the *McKean* case, *supra,* there were ten trusts, and each trust had three trustees and one beneficiary, which was the factual situation in the Lombard Trust until March 14, 1937. If respondent's contention be correct that petitioner was an association while Dr. Lombard was the sole beneficiary, there would have been ten associations in the *McKean* case, and under the contention of the Collector

there, these ten associations would have constituted still another association.

Likewise, in *Magoon Trust Estate* (July 10, 1942), B. T. A. Memo No. 101503, the Commissioner unsuccessfully contended that two trusts, with common trustees, constituted an association taxable as a corporation.

In passing, we direct attention to the fact there is absolutely nothing in *Solomon v. Commissioner,* 89 F. (2d) 569, that intimates or holds there may be an association when there is only one person having a beneficial interest. In that case, there was created a trust under the Georgia law, which law provided for the issuance of certificates that "shall pass and be transferred as personalty and in the same manner as shares of stock in corporations; and the same shall be subject to levy and sale under attachment or execution or any other process, in like manner as shares of stock".

The declaration by which that trust was created provided that 1100 certificates should be issued to the grantor who in the same instrument transferred 1,000 of these certificates to the same trustees upon separate trusts for her 9 children and 2 grandchildren. These children and grandchildren immediately became beneficially interested. As each child's interest was held in trust for him, he was represented in the association by his trustees. Therefore, legally, there were as many associates as there were trusts for the children, plus one, representing the grantor. It was with respect to this situation that this court said: "It has been rightly determined to be an association, the grantor and five trustees who initially took title to the entire 1100 beneficial shares being the original associates." It was not claimed or held in that case that a subsidiary

trust with five trustees and one beneficiary constituted an association.

Respondent may contend that Dr. Lombard intended to form an association when the trust declaration was executed and hence, the trust should be deemed to have been an association from the first step. It may be conceded that at the time the trust declaration was executed in November, 1935, Dr. Lombard did intend or propose that *ultimately* the beneficial interest under the trust would be held by the members of his family and himself. Nevertheless, he did not intend them to be associated with him *at that time* for he himself retained the entire beneficial interest and he continued to keep and own such beneficial interest until March 14, 1935. He may not have understood the legal effect of all acts with respect to taxation, but he did knowingly take for himself and hold all beneficial interest until March 14, 1937, and during all of such times as he was free to carry out his intentions or to change or abandon them, and if he had died, all of the trust property would have been included in his tax estate. If the courts are to supply the legal effect of his associating others on March 14, 1937, the courts must also supply the legal effect of his conscious act of retaining to himself the full beneficial interest in the trust created by him.

In law, intent, unaccompanied by act, is never recognized, otherwise, as has been remarked, all of us would be criminals. Nor is mere intent recognized in the special field of tax law.

If it be contended that the acts of March, 1937, should be deemed to relate back to those of November, 1935, then what of the execution in September, 1938, of an amended declaration of trust, which the Board confesses "follows

more closely the form of a traditional trust" [T 70], and which was, in fact, a "traditional trust", taxable as a trust, if it be possible to make one? The evidence is clear there was no change of intention, and the 1938 amendment expressed what Dr. Lombard intended at the beginning. If the act in March, 1937, is to be made retroactive, let us be consistent and make the act of September, 1938, also retroactive, and having done that, all questions are answered and the trust from the beginning was the "traditional trust".

All Income From the Trust Property Prior to March 14, 1937, Was Returnable by and Taxable to Dr. Lombard.

Sec. 166 of the Revenue Act of 1936 reads:

> "Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested
>
> "(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or
>
> "(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor."

Article 166-1 of Regulations 94 provides in part:

> "(a) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of

sections 161, 162 and 163, but remains attributable and taxable to the grantor. . . .

"(b) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

"(1) Whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to *alter* or *amend*, or to appoint; . . .

"(4) Whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A *bare legal interest, such as that of a trustee, is never substantial and never adverse.*

* * * * * * * * *

"(d) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created."

Except for changing the term "Act" to "Internal Revenue Code", the corresponding article under regulations 103 reads as above.

The history of income from revocable trusts is reviewed in the recent case of *Welsh v. Bradley,* July 24, 1942, C. C. A. 1, No. 3772. It is there shown that as early as 1916, Congress provided for taxing trust income to the trustees, but the Treasury promptly ruled that the statute applied only when a trust was "irrevocable by the donor, otherwise the income from the property in question will accrue to the donor and must be accounted for by him"; and the 1918 regulations provided, "The income of a revocable trust must be included in the gross income of the grantor."

The Court in *Welsh v. Bradley, supra,* says:

> "In 1924 Congress expressly enacted the earlier Treasury practice of treating revocable trusts as an exception to the general provisions applicable to the taxation of income of trust estates. . . .
>
> "On the face of §219 (g) of the 1924 Act, it might be considered that there was an ambiguity in the provision that in the case of revocable trusts, 'the income' of the trust 'shall be included in computing the net income of the grantor'. Did Congress mean by 'the income' of the trust (1) the taxable net income of the trust, computed on the basis of considering the trust a separate entity, or (2) the gross income derived from the trust property determined by the criteria of the tax laws as if the trust had not been created? From the very beginning the Treasury has adopted the second interpretation, consistent with its earlier rulings before Congress had dealt specifically with revocable trusts.
>
> "This interpretation has been consistently adhered to under corresponding sections of the succeeding revenue acts."

The Court held valid the regulation under section 166 hereinbefore quoted requiring the gross income from the trust property to be included in the gross income of the grantor.

For three separate and distinct reasons, hereinafter mentioned, said section 166 of the Revenue Act of 1936 required the income from the trust property prior to March 14, 1937, to be returned directly by Dr. Lombard.

(a) Dr. Lombard and the other trustees (who did not have substantial adverse interests) had power to revest in Dr. Lombard parts, up to the whole, of the corpus by merely distributing it to him without any modification of the trust indenture. (The requirement of the statute would have been satisfied had there been power to revest only *part*.)

Article 9 of the trust indenture provided that "all income and estate funds" might be invested or distributed in the discretion of the trustees. [T 30.] By Article 17, the trustees were empowered at any time to make partial distributions, and upon termination of the trust, to distribute the residue, all distributions to be apportioned to the beneficiaries. [T 34.] By Article 18, the duration of the trust and its termination were committed to "the discretion of the Trustees". [T 34.]

Therefore at any time prior to March 14, 1937, the entire corpus and accumulated income might have been distributed to Dr. Lombard as sole beneficiary.

(b) Dr. Lombard and the other trustees (who did not have substantial adverse interests) had power to alter or amend the trust declaration so as to restore all or part of the corpus to Dr. Lombard.

In Article 22 of the trust declaration it was provided that the trust declaration might "be altered and/or amended at any time by the Full Membership of the then acting Board of Trustees".

(c) The trust was a revocable trust under California law and might have been revoked at any time by its grantor, Dr. Lombard.

Prior to its amendment in 1931, Section 2280 of the California Civil Code read:

> "A trust cannot be revoked by the trustor after its acceptance, actual or presumed, by the trustee and beneficiaries, except by the consent of all the beneficiaries, unless the declaration reserves a power of revocation to the trustor, and in that case the power must be strictly pursued."

This was the prevailing rule, namely, that a trust was irrevocable in the absence of a reserved power to revoke. (65 C. J. 340.)

In 1931, the code section was amended to provide

> "unless expressly made irrevocable by the instrument creating the trust, every voluntary trust shall be revocable by the trustor by writing filed with the trustee. When a voluntary trust is revoked by the trustor, the trustee shall transfer to the trustor its full title to the trust estate."

Article 21 of the trust declaration reads in full [T 35-36]:

> "Art. 21. Amendments: While Conveyance and Delivery of Properties herein described and referred to is Irrevocable, should any part or portion of these articles of covenant, whatsoever, be construed by any

> Court to be contrary to or in contravention of law, it is the purpose and intention of all parties hereto, that in so far as this Conveyance and Contract is legal it shall continue in full force and effect and the Trustees shall operate thereunder. These Articles of Covenant for formal administration may be altered and/or amended at any time by the Full Membership of the then acting Board of Trustees jointly executing and attaching an appendix hereto, a copy of which with due reference hereto should be recorded in public records wherever this original instrument was previously recorded."

The article is entitled "amendments", and it specifically deals with and provides for two important matters, one, that void provisions shall not affect the validity of remaining provisions, and two, that the trustees may amend. It also contains an adverb clause reading: "While conveyance and delivery of properties herein described and referred to is irrevocable." That clearly is an assumption or recital. If this trust had been created prior to the 1931 amendment, the trust would have been irrevocable as a matter of law and the recital would have been clearly appropriate. It would also have been appropriate in those states following the general rule of irrevocability.

Under the present law, for a trust to be irrevocable, it must expressly be made irrevocable by the trust declaration. If the clause would have been a mere recital of a fact under the former law, how may it be held under the present law to be an express surrender of the right of revocation that the law preserves? It might be contended

the recital implies that the grantor intended to make the trust irrevocable. But the law preserves the right of revocation against mere implications in requiring an express surrender.

Explanation for the meaningless statement must be found in the fact we are dealing with a copyrighted form intended for use anywhere, and it is fairly evident the draftsman assumed the general rule as to irrevocability without regard to the special laws of California.

But apart from the foregoing consideration, when the settlor is the sole beneficiary, he may revoke the trust without the consent of the trustee even though the instrument expressly states that it is irrevocable. (65 C. J. 343.) Under the former law, the trust would have been irrevocable when others than the creator of the trust were beneficiaries; but under such law, while Dr. Lombard *as creator* was the sole beneficiary, he could have revoked it. There is nothing in the new law that prevents revocation when the grantor is also the sole beneficiary.

A trustee does not have a substantial adverse interest. (*Reinecke v. Smith*, 289 U. S. 172; *Greenough v. Commissioner* (1934—C. C. A. 1), 74 F. (2d) 25; *Morton v. Commissioner* (1940—C. C. A. 7), 109 Fed. (2d) 47.)

Where a grantor has the right to amend or revoke with the consent of any two of the trustees, the income is taxable to the grantor as the trustee does not have an adverse interest. (*Wetherbee v. Commissioner* (1934—C. C. A. 2), 70 F. (2d) 696.) A father, trustee of a family trust, is not a person having a substantial adverse interest. (*Loeb v. Commissioner* (1940—C. C. A. 2), 113 F. (2d) 664.)

Dr. Lombard Could Not Make His Gift Retroactive to February 10, 1937, so as to Relieve Himself From Returning Income Accrued to March 14, 1937.

On November 25, 1940, the U. S. Supreme Court rendered two decisions holding that one who is entitled to receive income at a future date and who makes a gift of it realizes taxable income, as much as if he had collected it and paid it to the object of his bounty.

In *Helvering v. Horst*, 311 U. S. 112, it was held that interest coupons given away prior to their maturity were taxable as income to the donor on a cash basis.

In *Helvering v. Eubank*, 311 U. S. 122, it was held that renewal insurance commissions after termination of the agency contract, voluntarily transferred by the ex-agent, were taxable as income to the agent when received by the transferee.

The cases mentioned were followed on March 31, 1941, by *Harrison v. Schaffner*, 312 U. S. 579, where a life beneficiary of income from a trust assigned to children specified amounts out of income of the following year. It was held such assignment did not relieve the assignor from tax on the income assigned.

In *Duran v. Commissioner*, BTA Memo., No. 98027, it appeared that on January 1, 1922, an insurance agent, by virtue of 20 years service, became entitled to an annuity for life provided he did not enter the service of another agent irrevocably assigned to his sister his right to receive the annuity payments. Held, that the power to dispose of income is equivalent to ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and, hence, the realization of the

income by him who exercises it. The annuity payments to the sister were taxable to the assignor.

The identical point here involved was passed upon in *Rose L. Ray,* BTA Memo, No. 101, 315, June 26, 1941. In the *Ray* case a husband and wife created trusts for the benefit of three children, the corpus consisting of oil and gas leases that were producing income. The trust instruments were prepared before November 1, 1935. They recited they were effective as of that date and the grantors reserved all income from the property prior thereto. The trust corpus was formerly owned by a partnership. The partnership books were closed as of November 1st, 1935, new books were started and from November 1, 1935, the income was distributed on the books according to the rights of the beneficiaries. Gift tax returns covering the trust property were filed. The property was valued for gift tax by a revenue agent as of November 1, 1935 and the case insurance company. Prior to the taxable year 1934, the closed. However, the trust declarations and conveyances were not actually executed until December 23, 1935. It was held that all income accruing prior to December 23, 1935, was taxable to the grantors, notwithstanding the trustees were entitled to the income from November 1, 1935.

In the instant case there was payable to the trustees on March 14, 1937 the sum of $1,868.96 as the balance of the sale price of the crop of oranges sold February 23, 1937. This was received on April 15, 1937. The full amount of this item of $1,868.96 was *net* income as the purchaser picked and hauled the fruit and the trustees neither incurred nor paid any expense in connection with the crop after its sale on February 23, 1937. [T 14.]

If petitioner became an association on March 14, 1937, the legal effect was as though, on that date, a trust, of which Dr. Lombard was sole beneficiary, transferred to an association created on that date, the right to receive this item of income. But under the cases, such transfer would not relieve the transferror from accounting for the income. However, under the statute, the income was that of Dr. Lombard's for tax purposes. Dr. Lombard could not escape liability because the transfer was made by the trustees rather than by himself. If such item of $1,-868.96 is to be included in Dr. Lombard's income, it follows that it is to be excluded from petitioner's income for the period March 14, 1937 to December 31, 1937.

The Ultimate Findings or Conclusion of the Board Are Not Supported by the Evidence.

In the findings, after reciting stipulated and admitted matters, the Board concluded [T 65]:

> "A trust at law was not created by Dr. Lombard by his execution on November 3, 1935, of the several instruments constituting the Hulbert Plan, and petitioner was not a trust prior to or during the taxable year. Rather, some type of enterprise in the nature of a family corporation was created under the Hulbert Plan. Dr. Lombard transferred absolute title, legal and equitable, to various properties, real and personal, to himself, Norman Lombard and Bertha Lombard, as joint tenants. They, and they only, were the equitable as well as the legal owners of the property. They and their successors only, could determine who should eventually receive distribution of the property upon liquidation of the enterprise. During the taxable year, 1937, petitioner was an association within the meaning of Section 1001 of the Revenue Act of 1936."

The foregoing is manifestly a conclusion of law and not a finding. Assuming it to be a finding of ultimate facts, it is without support in the evidence.

The opinion reveals close examination of details. The details of the Hulbert Plan are so vague, weird and unusual that one may be pardoned, who, contrary to the precept requiring substance to control form, becomes enmeshed and confused in details, attributing verity to statements that thoughtful consideration would show to be erroneous.

In the opinion it is said, in effect, that a trust was not created by the trust declaration for the reason the trustees became the legal and equitable owners of the property and the trust declaration did not name any beneficiary or *cestui que trust.* [T 65.] Article 15 of the conveyance and contract expressly required initial registration of the "expectancy fractions" to be according to instructions "delivered to the Board by Norman M. Lombard". [T 32.] Such instructions were delivered, and it was stipulated "said conveyance and contract and said instructions as to beneficaries *were executed as a part of and to evidence a single transaction and agreement*". [T. 9.]

An agreement may be expressed in several writings. This is true of trusts. At 65 C. J. 275, it is written:

> "A trust may be declared by means of several writings. The writings need not be contemporaneous nor *inter partes.* Contemporaneous instruments may be a sufficient declaration of trust, if when construed together, they show the intent to create a trust."

In this instance the instructions to register all expectancy fractions in Dr. Lombard was as much a part of

the trust declaration as the conveyance and contract. The holder of the expectancy fractions was entitled to all distributions, whether interim or final. Therefore, a beneficiary or *cestui que trust* was not only provided for but was distinctly named in the trust declaration. There was no justification for or merit in the statement in the opinion, "There was no conveyance to trustees in trust for named or personal beneficiaries as is typical of the traditional trust. The 'beneficiaries' were only impersonal registrants holding units of interest in earnings and proceeds." [T 68.]

The method used to name the beneficiary was unusual but that does not militate against the fact that a beneficiary was provided for and named in the trust declaration.

In the findings (or conclusion) hereinbefore quoted, it was declared that Dr. Lombard transferred "*absolute* title, legal and equitable" to persons who "were the equitable as well as the legal owners of the property" and who "could determine who should eventually receive distributions". [T 65.] Again, "Dr. Lombard conveyed the complete legal and equitable title to property." [T 68.]

There seems in the opinion to be a thought that the trustees acquired an interest or right greater than trustees of a strict trust acquire. At 65 C. J. 526, it is said:

> "Where the use is executed, the trustee takes no estate or interest; but where the use is valid and not executed, he is vested with the legal title, and at law the legal estate in the trustee possesses the same properties, characteristics and incidents as if he were the absolute owner, but there is authority which terms the trustee as merely a depositary of the legal title, and his estate but a power that may be exer-

cised. Some statutes provide that the trustee shall take both the legal and equitable title and the beneficiary only the right to enforce the performance of the trust, and under such or similar statutes the trustee is vested with the whole estate, subject to the execution of the trust."

Section 863 of the California Civil Code provides:

> "Except as hereinafter otherwise provided, every express trust in real property, valid as such in its creation, vests the whole estate in the trustees, subject only to the execution of the trust. The beneficiaries take no estate or interest in the property, but may enforce the performance of the trust."

The rule that a trustee takes the legal and equitable title or the "whole estate" applies to the *quantum* of estate taken. A trustee takes only the *quantum* that is necessary for the execution of the trust. Thus, one may purport to convey to a trustee fee title absolute, but if a life estate is all that is required for the execution of the trust, the trustee would take only a life estate, but in such life estate he would have the legal and equitable title. The rule is well stated in the following quotation from *Hunt v. Lawton*, 76 Cal. App. 655 (245 Pac. 803):

> "In *Morffew v. San Francisco & S. R. R. Co.*, 107 Cal. 587 (40 Pac. 810), the court had under consideration the *quantum* of estate taken under a decree of distribution by a trustee, to whom lands were distributed for the term of her natural life, in trust, to apply the income for the support and education of certain children. The court said: 'But the quantity of interest which passes to the trustee in case of an express trust is commensurate with the necessities of his office; the trustee shall have an estate in fee,

if that is necessary, to enable him to perform the duties imposed upon him, although it is not in terms given to him by the instrument creating the trust; on this principle a devise of lands in trust to sell clothes the trustee with the fee, because necessary to the execution of the trust. The rule being compendiously stated that the trustee "will take an estate adequate to the execution of the trust—no more or less". *Perry on Trusts*, sec. 320, *Young v. Bradley,* 101 U. S. 787 (25 L. Ed. 1044).)'

"In general, whatever the language by which the trust estate is vested in the trustee, its nature and duration are governed by the requirements of the trust, and in equity the extent and quality of the trustee's estate is commensurate with, and dependent largely upon, the purposes of the trust and the duties imposed thereby on the trustee as expressed in the terms of the instrument creating the trust; the trustee takes exactly that quantity of interest, whatever it be, which the proper execution of the trust may require, and no more, and even though granted to the trustee to the fullest extent, the legal estate will not be carried further than the trust requires."—65 C. J. 527-529.

The trust declaration did provide for a beneficiary. On November 3, 1935, property was conveyed to others for the benefit of Dr. Lombard. That created what is known as a trust. Whether it was to be classified for taxation as a strict trust is beside the question at this point. The principles under consideration apply as much to a trust that will be taxed as an association as to one that will be taxed as a trust. Therefore, the trustees took such *quantum* as was necessary to the execution of the trust. As they were given power to sell and convey, in fee, they

necessarily took a fee. And they took, as trustees, the legal and equitable title in fee.

There seems, in the opinion, a pronounced thought that when a trust is to be classified as an association for taxation, the general principles applicable to trusts no longer apply. Nothing could be more wrong.

The mumbo jumbo in the trust declaration such as "said trustees become sole owners of an estate with no restraints on powers of alienation" [T 20] and "they (trustees) are hereby made, in fact, absolute and exclusive owners" probably impressed and awed the suckers who purchased and used it, but is absolutely meaningless to a lawyer.

In the opinion it is said that Dr. Lombard (on November 3, 1935) created "some type of enterprise in the nature of a family corporation". [T 65.] The term "family corporation" is loosely used to indicate a situation where members of a family own at least a majority of stock of a corporation and thereby control it. The term does not have reference to the directors, but to the stockholders. The directors might be, and frequently are, bookkeepers, secretaries or others in the employ of the corporation or the stockholders. At least they are responsive to the stockholders. The term "family corporation" is not used to apply to one who owns all of the stock of a corporation. Now, if Dr. Lombard had formed a corporation and taken all of its stock, he would not, nor would the corporation, have been referred to as a "family corporation". Therefore, any suggestion that in 1935 Dr. Lombard formed something in the nature "of a family corporation" is meaningless.

It is also said, "In form, petitioner resembles a 'Massachusetts trust'". [T 72.] The Board appears to have difficulty in classifying petitioner. Petitioner was not a corporation nor a partnership. If the tax laws might have been forgotten for a moment, the Board would have had no difficulty in labeling petitioner. Then the only question would have been, is petitioner a trust that is to be classified as an association for taxation? If the Board would refer to the discussions in the oft quoted Supreme Court cases, or to the opinion of this Court in the *Porter* case, or to the regulations, the Board would find that trusts classified for taxation as associations are still trusts under general laws and referred to as such. The Board approaches the question as though a new species of organization unknown to law, had been created. It incorrectly says that petitioner had no beneficiary or *cestui,* and, therefore, concludes petitioner could not be a trust.

The question is not so difficult as the Board makes it. A trust was created in November, 1935, of which Dr. Lombard was the sole beneficiary. No trust of which the grantor is the sole beneficiary has ever been held to be an association, nor can it be, for there must be a plurality of persons for whose benefit the enterprise is conducted before such an organization is to be classified as an association. Whether the association be in trust form or other form, there still must be more than one member or beneficiary to make the organization subject to taxation as an association. Until March 14, 1937, Dr. Lombard was the creator and sole beneficiary. As the organization could not under any circumstances be classified as an association prior to March 14, 1937, it might only be classified as a trust, but for reasons noted, it was not taxable as a trust. Rather, all income was returnable

directly by Dr. Lombard. The Commissioner was closer to being correct than his attorneys or the Board.

In the opinion it is said, "Thus, it appears that Dr. Lombard, his wife, and his eight children, became associates". [T 69.] That statement does not answer our point that prior to March 14, 1937, Dr. Lombard had no associates. While at places the opinion appears to recognize the legal necessity of more than one beneficiary before there may be an association, it ignores the fact that prior to March 14, 1937, Dr. Lombard had no associates. The opinion just does not meet and answer the point.

In the opinion emphasis is given to the fact that the trust had rental properties, raised oranges and had substantial receipts. [T 71.] From this is the deduction that the trust is a business enterprise. The deduction is unwarranted. In the trust are the properties conveyed to the trustees by Dr. Lombard. Had the trust been the strictest of strict trusts, would not the trustees have collected the rents and produced fruit on the orchard? The activities of the trustees in this particular are no evidence that the trust was formed for a business purpose or that it was not.

It does appear, however, that during the 4 years and 3 months that elapsed between March 14, 1937 and the hearing, the trustees made only two sales apart from ranch products, and sold only one small block of stock and one small block of bonds. [T 15.] This is some evidence of inactivity and lack of profit purpose. It shows that the trustees were engaging only in the business of managing the properties received from Dr. Lombard. The Board fails to note such inactivity and its significance, while drawing an unwarranted inference from the fact that the trustees managed the property received from Dr. Lombard.

The Board Erred in Refusing or Failing to Consider Evidence of Purpose.

In *Porter Property Trustees, Ltd., supra,* this Court said:

> "There are two tests to be applied to a trust in order to determine whether or not it is taxable as a corporation: (1) what is its purpose?; and (2) what is the extent of its business activity? Of the two, the first is the more important."

The second point respecting activity was hereinbefore commented upon. As noted, the activities have been confined to managing the property received from Dr. Lombard. The trustees did not engage in drilling oil wells or in subdividing and selling lands. They did not engage in buying and selling securities. Only one change in the securities was made. They could not have done less had this been a strict trust in the four years and three months elapsing after March 14, 1937. On March 24, 1937, the trustees sold stock of American Trust Company for $5,-145.35 and bought stock of Baltimore American Insurance Company for $5,133.75. [T 15.] If the business activities of the Lombard Trustees have any evidentiary value, they show the purpose of the trust was to manage and conserve property for the benefit of Dr. Lombard, Mrs. Lombard and their children.

In trusts, purposes and powers are often confused. Most strict trusts confer broad powers upon the trustees. In "Forms of Wills and Trusts distributed exclusively to attorneys-at-law by the trust department of Security-First National Bank of Los Angeles, Los Angeles, California, Fourth Edition, 1941", about 650 words are used to state *additional* powers in a form of testamentary trust. The

writer confesses to having drafted innumerable wills with trusts in which nearly three legal-size pages were required to enumerate the *additional* powers. Powers do not provide a criterion for determining whether a trust is to be classified for taxation as a strict trust or an association, and it is necessary to avoid the conclusion that the purpose of a trust must be thus and so as the trustees have power to do that.

To determine purpose, first look to the trust declaration. If the purpose is there stated or apparent, that will and should control. When the Supreme Court, in *Helvering v. Coleman-Gilbert Associates*, 296 U. S. 369, said "Weight should be given to the purpose for which the trust was organized, but that purpose is found in the agreement of the parties", it did not insert "written" before agreement. Manifestly, when people "associate" so as to form an "association", there must be some agreement. It might be wholly written, or wholly in parole, or in part each. If the written agreement is in writing and states the purpose of the association, then, says the Supreme Court. "the parties are not at liberty to say that their purpose was other or narrower than that which they *formally set forth* in the instrument under which their activities were conducted". The observations of the Supreme Court are sometimes misapplied.

In the trust declaration there is no statement of purpose. It does not state the purpose was to liquidate Dr. Lombard's property and distribute the avails, nor does it state the purpose was not to liquidate and distribute, but there is *power* to liquidate and distribute. It does not state the purpose was to hold and manage property for the benefit of Dr. Lombard's family and distribute the income to

them, nor does it show the purpose was not to do that, but there is power to do it. It does not state the purpose was to buy and sell property for profit, but there is power to do so. Hold the instrument by the four corners and its purpose does not appear. One can make conjectures. but he does not know what purpose Dr. Lombard had in mind in executing it or in transferring interests to the others.

Dr. Lombard testified to his purpose.

First, he wanted to relieve himself of responsibility. He was 83 years old. He wanted leisure to travel and he and his wife did travel abroad extensively after establishing the trust. [T 17-19.] That was not a business purpose. That was not a case of people associating themselves with a business motive, to make money by drilling for oil, subdividing lands, buying and selling, or conducting any of the numerous activities for which people associate for profit.

Secondly, he expected his wife, who was 19 years and 4 months younger, to survive him and he desired to provide her with an income for her support as long as she lived. [T 17.] (Note, that in the transfer and re-registration of March 14, 1937, 350 "expectancy fractions" were placed in the name of Dr. Lombard and Mrs. Lombard as joint tenants. [T 41.]) Again, this was not a business purpose. It is not a purpose out of which associations are formed. It is the identical purpose for which innumerable strict trusts are established, namely, to provide for the support of the widow of the grantor.

Finally, after he was gone, Dr. Lombard wanted the children to be able to sell the various properties and divide

the proceeds from time to time as the market justified. [T 17.] This was not a business purpose that induces people to associate for profit.

On September 30, 1938, the trust declaration was amended. [T 11.] The notice of deficiency was not mailed until June 15, 1940, more than 1 year and 8 months after the amendment. As amended, the trust was made irrevocable, the net income was made distributable annually to Dr. Lombard, Mrs. Lombard and the eight children and their issue, the beneficial interests were made incapable of alienation and authority was conferred to distribute cash or property in kind to those entitled to income. [T 44-52.] If it be possible to create an ancestral trust, the amended declaration does that.

What has been done by the parties after establishment of the trust has been reviewed and referred to in practically every decision as evidence of their purpose. In no case was there any act or thing as significant and persuasive as this solemn and formal writing. In the opinion it is written, "Petitioner asks us to go outside the terms of the agreement which was in effect in the taxable year for the purpose. This we cannot do." [T 70.] The statement is erroneous.

In the brief filed with the Board, appellant wrote:

> "In determining purpose, the acts of the parties after establishment of the trust are properly and usually referred to. Such appears in nearly every decision including that in the Porter case. The execution of the new trust declaration was an act of the parties interested in the trust involved in this case, and that act is understandable and relevant. The necessity for making certain the provisions of the

trust attempted to be stated in the first declaration and resolving questions of its validity are apparent to one having a superficial knowledge of trusts and conveyancing. The provisions of the new trust declaration are harmonious with those of the first trust declaration in so far as those of the first are possible of understanding.

> "Not only are *acts* of the parties relevant in determining the purpose for which a trust was created, but, manifestly, their declarations are relevant. The new trust declaration contains the solemn declaration and agreement of all the interested parties as to their purpose. It would be difficult to find any better or more persuasive evidence of purpose than the new trust declaration, affecting, as it did, valuable property rights."

From the statement of the Board, it is apparent the Board deemed it could not consider this amended declaration to determine that which had to be determined, namely, the purpose of the parties. Nor did it give any consideration to the testimony of Dr. Lombard except as hereinafter noted.

The Board said,

> "The general purpose stated in the 'Plan', the broad powers given to petitioner, the facts as to petitioner's activities, all lead to the conclusion, *in the absence of contradictory evidence*, that the purpose was to provide a method of putting all of Dr. Lombard's business properties under centralized and continuous management for realizing profits and distributing them to all who came into the plan." [T 71.]

There is no general purpose stated in the trust declaration, nor is there a specific purpose. For aught that appears in the trust declaration, Dr. Lombard and his "associates" may have had a purpose to use the profits for sending missionaries to Japan. There is nothing in the trust declaration requiring "profits" to be distributed to the beneficiaries, and the suggestion that the purpose was to realize profits and distribute them to the beneficiaries is purely gratuitous. The Board uses the expression "in the absence of contradictory evidence". If the purpose appears in the trust declaration, there may be no contradictory evidence of purpose. Evidently the Board does not find in the trust declaration satisfactory evidence of purpose. At the same time, it refuses to consider the abundant evidence of purpose.

At page 69, the Board says, "Evidence in this case which negatives the creation of a trust and which indicates an association is found in the fact that Dr. Lombard set about to obtain the consent of eight of the children to come into the plan". Evidently, for some purposes, the Board does consider evidence. The evidence to which it refers is part of Dr. Lombard's testimony. It uses that evidence to establish the trust was an association. It says, "Purpose is important, if not determinative". [T 70.] Therefore, the Board uses some of Dr. Lombard's testimony to prove *purpose*, but it refuses to consider evidence that would establish a different purpose.

The Board refers to and uses the evidence of transfers of "expectancy fractions" in 1937 and 1938 to establish

that the purpose was to create an association, while at the same time it says it cannot consider the amended trust declaration to help it determine purpose.

The fact is the Board freely uses everything it finds to establish a business purpose and rejects and will not even consider stronger and more persuasive evidence of a different purpose. We are aware of the right of the Board to weigh evidence. But there is no dispute or conflict in the evidence. It is apparent the Board acted under a misapprehension as to the law.

In *Porter Property Trustees, Ltd.* there was no specific evidence of purpose. Had there been none in the instant case, the Porter case would have been decisive on the question that after Dr. Lombard associated others with him as beneficiaries, the trust was an association. However, there was in the instant case an abundance of evidence on the question of purpose and it is apparent it has not been weighed and that the Board did not decide the case on the evidence.

Respectfully submitted,

Geo. W. Hellyer,

John B. Surr,

Attorneys for Petitioner.

No. 10289

In the United States Circuit Court of Appeals for the Ninth Circuit

LOMBARD TRUSTEES, LTD., A TRUST, AND CHARLES S. LOMBARD, BERTHA M. LOMBARD AND NORMAN M. LOMBARD, TRUSTEES THEREOF, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

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IRVING I. AXELRAD,
Special Assistants to the Attorney General.

INDEX

CITATIONS

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 10289

Lombard Trustees, Ltd., a Trust, and Charles S. Lombard, Bertha M. Lombard and Norman M. Lombard, Trustees Thereof, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 53–73) is unreported.

JURISDICTION

This petition for review (R. 75–77) involves federal income and excess profits taxes for the taxable year 1937. On June 15, 1940, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in income tax in the amount of $5,001.09 and excess profits tax in the amount of $2,015.10. (R. 1–2.) Within ninety days thereafter, the taxpayer filed a peti-

tion with the Board of Tax Appeals for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. The final order and decision of the Board of Tax Appeals sustaining the deficiency in income tax and excess profits tax in the respective amounts of $5,818.66 and $258.14 was entered on June 19, 1942. (R. 74.) The case is brought to this Court by a petition for review filed September 8, 1942 (R. 75–77), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the taxpayer, Lombard Trustees, Ltd., was an association, and therefore taxable as a corporation during the entire taxable year 1937, within the meaning of Section 1001 (a) (2) of the Revenue Act of 1936, as determined by the Commissioner and held by the Board of Tax Appeals, or a pure trust and taxable as such, as claimed by the taxpayer.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra,* pp. 36–42.

STATEMENT

The findings of fact of the Board of Tax Appeals (R. 54–65) were based on the stipulations of facts (R. 54.) These facts, as found by the Board or in the stipulations, may be summarized as follows:

Charles S. Lombard, hereinafter called Dr. Lombard, and Bertha M. Lombard were married in 1907 and reside in Redlands, California. Three children, Emily,

Winthrop and Ruth, were born of this marriage. Bertha Lombard also had two children, Ralph and Dorothy Pray, born of a former marriage, and Dr. Lombard had four other children born of a former marriage. They are Lillis Stowe, George Lombard, Charles S. Lombard, Jr., and Norman Lombard. Dr. Lombard was 83 years old in 1935 and Bertha Lombard was 63. The ages of the above children range from 52 to 22 years. (R. 54.)

In 1935 Dr. Lombard learned of a copyrighted printed plan called the "Hulbert Plan Trust," a copy of which he purchased from a representative of the publisher in San Bernardino. On November 3, 1935, Dr. Lombard and Bertha Lombard, as grantors, and Winthrop, Emily and Norman Lombard, as trustees, executed the "Hulbert Plan Trust." From that date and during the entire taxable year 1937 the agreement was operative and in full force and effect. On November 3, 1935, the day that the agreement was executed, two of the trustees, Emily and Winthrop Lombard, resigned and Dr. and Bertha Lombard succeeded them and with Norman Lombard have acted as trustees since. On November 3, 1935, also, Dr. Lombard conveyed to the trustees one parcel of business property and at other times during 1935 he conveyed six other pieces of business property, including an orange grove, and on December 31 he transferred securities. The real and personal property owned by Dr. Lombard at the beginning of 1935 was valued at $300,000. The dates, value, and description of the gifts made to the trust in 1935 are shown, *infra,* as reported by Dr. Lombard on his gift tax return for 1935. (R. 55, 61.)

The conveyance and agreement of November 3, 1935, was recorded on November 14, 1935, in the office of the recorder at San Bernardino County. All of the parties to the agreement were residents of California, and all property conveyed to the trustees pursuant to the agreement was located in California. (R. 55.)

The "Hulbert Plan" was a series of legal instruments rather than a trust indenture. The first instrument, entitled "Conveyance and Contract," was executed by Dr. and Bertha Lombard. By this agreement they, as "grantors," appointed three trustees who were to use in their collective capacity the trade name, Lombard Trustees, Ltd. The "grantors" conveyed to the "trustees" for $100 and other valuable consideration, property described in a "deed" which was made part of the instrument. The "grantors" sold, assigned and conveyed the property to the "trustees" as joint tenants and as "the exclusive owners" with power to sell, mortgage, and encumber the property in their own discretion, "without hindrance from, submission to, or approval of 'beneficiaries.'" The document expressly stated that the "trustees" should be unrestricted in their ownership, control, administration and disposition of the "estate." (R. 55–56.)

The second instrument was executed by the "grantors" and the "trustees," and comprises an "Acceptance" by the "trustees" and a "Contract containing Articles of Administration" to which the "trustees" agreed. The "trustee" accepted their appointment and the property conveyed to them and they agreed to "conserve," "handle and barter," "manage and administer" the property and its accretions. (R. 56.)

The "trustees" agreed with each other in "Articles of Administration" which provided that the "trustees" should "be construed to be the absolute and exclusive owners, in joint tenancy and continuity, of the legal and equitable title to all property, real and personal in the Estate." The document authorized the "trustees" to act in their trade name through authorized officers, to hold regular and special meetings and to adopt and use a seal. (R. 56–57.)

The Articles set forth the general power of the "trustees" as follows (R. 57):

> Art. 3. Powers: Being Natural Persons these Trustees, their associate and/or successor Trustees, shall organize themselves into a Board, and may do collectively, in their discretion, any lawful things which citizens may lawfully do in any or all States unless herein limited. (It should be remembered: "Corporations possess only such powers as are granted to them by law, while individuals possess all powers except those prohibited by law.") They may own real estate or personal property in any State without limit, may buy, sell, improve, exchange, assign, convey and deliver, may grant trust deeds and may mortgage or otherwise encumber for obligations; may own stock in or entire charters or corporations, and may engage the Estate funds and properties in any industry or investment in their discretion, *hoping thereby to make gain to the Estate.* * * * (Italics supplied.)

The "Articles of Administration" provided for limited liability of the "trustees." It provided that the "trustees" were to keep records and make ther financial reports annually. They were also to allot in the

records "expectancy fractions" under instructions to be delivered by Norman Lombard, one of the "trustees." The "trustees" were enjoined to refrain from any actual or pretended issue or sale of capital stock in or of their Estate, such being a corporation prerogative and they were also prohibited from issuing or selling any equities or beneficial or equitable interest in the Estate. (R. 57–58.) It was provided, however, that "Dormant fractions, their usefulness being contingent upon possible future convenience, remain subject to the discretion of the Trustees." (R. 33.) The "Articles" provide further that "it is advisable to elect presiding officer and select and appoint a Board Secretary and/or other officials, to delegate duties and authority"; the trustees shall fix and pay all compensation to officers, agents and employees and in their discretion pay themselves "reasonable" compensation. (R. 29.)

Nowhere in the "Hulbert Plan" which was executed is there a conveyance to trustees for the benefit of *cestuis que* trust. Although the "Plan" contemplated that expectancy fractions" should be "allotted as to beneficiaries," as a matter of record only, in a "Register," it is provided that such allocation shall be a "guide" to enable the "trustees" to properly "apportion each distribution." The matter of allotting "expectancy fractions" meant no more than making a record of who was entitled to receive distributions and the proportion each would receive, if, as, and when any distributions were ever made, which was entirely within the discretion of the "trustees." (R. 58.) Death of a beneficiary would not entitle the heirs to demand a portion or distribution of "Estate" funds, but legal heirs

may succeed to the expectancy. A beneficiary is defined as "One Who Tenants Property, subject to and without affecting the discretion, management and/or absolute ownership of the Trustees in whom legal and equitable title to all Estate properties are Vested." (R. 33.)

The transfers of property to "trustees" were irrevocable, and they were to hold the property until they decided to liquidate, but the longest period was fixed, so as not to violate the rule against perpetuities, by the life of the last surviving subscriber to the agreement or registered "beneficiary." (R. 59–60.)

The third instrument, constituting a part of the "Hulbert Plan," was the direction from Norman Lombard to the "Board of Trustees" to register Charles S. Lombard as a "beneficiary" and to allocate to him 600 "expectancy fractions" out of a total of 1,200, leaving 600 dormant "expectancy fractions." (R. 59.)

The persons registered as having "expectancy fractions" could, however, be changed. On February 10, 1937, Dr. Lombard requested in writing that the board of trustees of taxpayer vacate the registration of the 600 "expectancy fractions" in his name and reallocate and re-register them so that 350 fractions be re-registered in the name of himself and Bertha Lombard as joint tenants, and that 50 fractions each be registered in the names of Norman, Winthrop, Emily and Ruth Lombard and Dorothy Pray. At a meeting of the board of trustees on March 14, 1937, the request was approved by resolution and the secretary was directed to register the new beneficiaries in accordance with the request. The resolution stated that the board of

trustees approved "the registrations as of the date of the Request, February 10, 1937." The registrations were made in the register on March 14, 1937. The re-registrations in the names of the various beneficiaries were made without consideration. On February 25, 1938, Dr. and Mrs. Lombard requested the taxpayer's board to vacate the "expectancy fractions" registered in their names and re-register them as follows: Two hundred to themselves as joint tenants and 50 each to George S. Lombard, Charles S. Lombard, jr. and Lillis S. Stowe. At a meeting of the "trustees" on February 26, 1938, a resolution was adopted approving the request and the re-registrations were made in accordance therewith. No other re-allocations nor re-registrations have been made. (R. 60–61.)

Dr. Lombard filed a gift tax return for 1935 in which he reported transfers of property to Lombard Trustees, Ltd., with values as follows (R. 61):

November 3, 1935, real property, Redlands	$5, 610. 00
November 19, 1935, real property, lot, Redlands	24, 190. 00
November 19, 1935, real property, lot and building, Redlands	17, 540. 00
November 19, 1935, real property lots	13, 830. 00
November 19, 1935, real property, lot and filling station Riverside	810. 00
November 19, 1935, real property, 4 lots, San Diego	2, 500. 00
November 19, 1935, real property, orange grove Redlands	2, 000. 00
December 31, 1935, stocks	64, 587. 93
	$131, 067. 93

Several of the pieces of real estate conveyed to the taxpayer are business properties, stores and offices, which are rented. In 1937 these business properties and the orange grove produced income which was reported by the taxpayer on Form 1041, "Fiduciary Income Tax Return," as follows (R. 62):

Dividends	$4,234.95
Interest on bank deposits	200.00
Rents—net—after repairs, depreciation and expenses	14,230.05
Receipts from orange grove—net—proceeds from sale of oranges	10,048.12
Total	$28,713.72

The taxpayer in the aforesaid fiduciary income tax return reported net income after deductions in the amount of $23,014.05. Among the deductions taken were the following: Interest paid on note for $39,000, $2,052.52; city and county taxes on property, $155.92; state income tax, $137.50; social security tax, $14.94; miscellaneous expenses, $425.68; salaries, $2,904.84. Attached to the fiduciary income tax return was Form 1040 F, "Schedule of Farm Income and Expenses." On this return the taxpayer reported $24,634.95 from the sale of oranges and $494.66 from receipts from "water and pipeline," and miscellaneous, and total ex-
receipts of $10,048.12. The expenses of operating the orange
penses of $15,081.49, leaving net grove included wages, fertilizers, spraying materials, fuel, taxes, insurance, water rent, smudge oil, tractoring, telephone and repairs. (R. 62–63.)

Taxpayer reported in the fiduciary income tax return as distributable income of the registered beneficiaries total net income for 1937 as follows:

Norma Lombard	$1,917.84
Emily Lombard	1,917.84
Ruth Lombard	1,917.84
Winthrop Lombard	1,917.84
George Lombard	1,917.84
Charles S. Lombard	5,753.51
Bertha Lombard	5,753.50
Dorothy Pray	1,917.84
	$23,014.05

On January 1, 1937, there was on the orange grove a matured crop of navel oranges. On February 23,

1937, the navel orange crop was sold for the sum of $2.80 per hundred pounds on the trees. The buyer was to pick and haul, and the picking was to begin March 1, 1937, and to be completed by April 10, 1937. The crop was picked by the buyer between March 1, 1937, and April 13, 1937. No expense was incurred or paid by the "trustees" in connection with the crop after its sale on February 23, 1937. The following amounts were received by the taxpayer for the crop: February 23, 1937, $10,000; March 10, 1937, $5,000; April 15, 1937, $1,868.96. In determining the net income for different periods in 1937 above, each payment received for the oranges was credited to gross income for the period in which received. (R. 63–64.)

The only sales made by the "trustees" apart from ranch products after March 14, 1937, were the following: March 24, 1937, stock of American Trust Company costing $5,189.44 was sold for $5,145.35 and stock of Baltimore American Insurance Company was purchased for $5,133.75; on July 13, 1938, bonds of Kansas City School were sold for $5,520.75. (R. 64.)

On June 14, 1940, which was prior to the mailing of the notice of deficiency herein, the taxpayer mailed to the Collector of Internal Revenue, Los Angeles, a duly executed capital stock tax return on Form 707 for the year ending June 30, 1937, wherein the value of the taxpayer's "capital stock" was declared to be $150,000. The taxpayer enclosed a check in the amount of $213.75 for the payment of the capital stock tax of $150, a 25-percent penalty for delinquency, $37.50 and interest from August 1, 1937, $26.25. The amount so paid has

never been refunded to the taxpayer and no claim for refund has been filed or made. (R. 64.)

The taxpayer's adjusted net income for the entire calendar year 1937 was $22,902.04, of which $4,234.95 was from dividends. (R. 64.)

A trust at law was not created by Dr. Lombard by his execution on November 3, 1935, of the several instruments constituting the Hulbert Plan, and taxpayer was not a trust prior to or during the taxable year. Rather, some type of enterprise in the nature of a family corporation was created under the Hulbert Plan. Dr. Lombard transferred absolute title, legal and equitable, to various properties, real and personal, to himself, Norman Lombard, and Bertha Lombard, as joint tenants. They, and they only, were the equitable as well as the legal owners of the property. They and their successors, only, could determine who should eventually receive distribution of the property upon liquidation of the enterprise. (R. 65.)

On the basis of the foregoing facts the Board of Tax Appeals affirmed the Commissioner's determination (R. 1–2) based on his amended answer at the hearing before the Board (R. 3), in which it was claimed that the taxpayer was an association taxable as a corporation during the entire year of 1937 (R. 65-73). The Board thereupon entered its decision (R. 74) from which the taxpayer petitioned this Court for review (R. 75–77).

SUMMARY OF ARGUMENT

The taxpayer was taxable at corporate rates throughout 1937. This Court in *Porter* v. *Commissioner,* 130 F. 2d 276, consistent with all the authorities, stated the

test of treating a nonincorporated organization as a corportation as first, and more important, it must have a business purpose, and second, it must have business activity. The Board of Tax Appeals found both factors. These findings are supported by substantial evidence and may not therefore be disturbed on review. Moreover, the instruments on the basis of which this Court affirmed the Board's finding of a business purpose in the *Porter* case are identical with the ones here involved. The Board correctly refused to consider evidence outside the "trust" instruments in ascertaining the purpose of the taxpayer.

The fact that Dr. Lombard was the sole registrant of expectancy fractions until March 14, 1937, requires no different conclusion as to taxpayer's status prior to that date. Three or more "associates" existed at all times in the form of trustees, who unlike the trustees in the ordinary trust, had absolute ownership of the property. Moreover, it was contemplated at the outset that the organization was to be utilized to bring in additional registrants of participating fractions. In either view there were "associates". But if form is of any importance, it is, only to the extent that the tax result changes as an organization looks more or less like a corporation. And corporations with but one stockholder or one beneficial owner are common. The taxpayer had all of the features of a corporation except incorporation—separate entity, trade name, seal, limited liability, transferable interests, centralized management and continuity. The "association" concept was designed only as a catch-all for "business-purpose" en-

tities short of incorporation. Nothing turns on how close a taxpayer approaches the notion of association in the abstract. If it has a business purpose and business activity and is an entity distinct from an individual so as to secure the advantages of the corporate form, it is taxable as a corporation.

Counsel's argument, that the income of the trust from January 1 to March 14 of the taxable year is taxable to Dr. Lombard, under Section 166 of the Revenue Act of 1936, as grantor of a revocable trust, is untenable. Whether a business trust is revocable or not, Section 1001 (2) is applicable to tax the income to the trust and no provision is made for taxing income of business trusts to grantors where they, or persons not having substantially adverse interests, have the power of revocation. This position is confirmed by a consideration of the statutory plan which has always made a distinction of the most fundamental nature between corporate income on the one hand, and individual or trust income, on the other. In the case of traditional trusts income is taxable either to the grantor, beneficiaries or fiduciary, but in the case of corporations the act makes no provision except to tax income to the entity. Thus when it is established that the income of a trust is to be taxed as a corporation pursuant to Section 1001 (2), the income must necessarily be taxed to the trust. There are no provisions for doing otherwise. To say that the income is taxable to the grantor under Section 166 requires that it first be established that a traditional trust is involved rather than a business type.

ARGUMENT

The taxpayer, Lombard Trustees, Ltd., was an association taxable as a corporation during all of 1937

(a) The taxpayer was organized for a business purpose and engaged in continuing business activity during the entire taxable year

The Board of Tax Appeals found that the taxpayer, Lombard Trustees, Ltd., was organized for the purpose of putting all of Dr. Lombard's business properties under centralized and continuous management for realizing profits and distributing them to all who came into the plan and that it was a business enterprise whose activities included renting several properties, managing buildings and growing oranges. (R. 71.) On the basis of these and other findings of fact, it held that the taxpayer was an association and therefore taxable as a corporation during the entire taxable year 1937 (R. 73) pursuant to Section 1001 (a) (2) of the Revenue Act of 1936 which provides that "When used in this act * * * The term 'corporation' includes associations."

The taxpayer was created by the use of copyrighted forms called the "Hulbert Plan". (R. 65.) It was these identical forms which were involved in *Porter* v. *Commissioner,*[1] 130 F. 2d 276, affirming *Porter Property Trustees, Ltd.* v. *Commissioner,* 42 B. T. A. 681, in which this Court decided that the taxpayer was an association taxable as a trust. This Court there said (p. 279):

> There are two tests to be applied to a trust in order to determine whether or not it is taxable as a corporation: (1) What is its purpose?; and

[1] The findings below make this clear, 42 B. T. A. 681, 690.

(2) what is the extent of its business activity? Of the two, the first is the more important. * * *
The Board's finding of a business purpose was based on the general purpose stated in the "Plan", the broad powers given to the taxpayer and its business activities. It is submitted that this finding is fully supported by substantial evidence and is therefore binding on this Court. *Phillips* v. *Commissioner,* 283 U. S. 589, 600; *Helvering* v. *Rankin,* 295 U. S. 123, 131. It would seem unnecessary to review the provisions of the documents by which taxpayer was established since it is apparent from a comparison of the statement, *supra,* with the findings of the Board of Tax Appeals in the *Porter* case, *supra,* that the documents were identical except for differences in names. Since the documents are identical the remarks of this Court in *Porter* v. *Commissioner,* 130 F. 2d 276, concerning the intention expressed therein apply with equal force here (p. 280):

> There is here no expressed purpose of liquidation, or of conservation, but an avowed intent "to engage in any lawful business" in order to realize a gain or profit to the trust estate. Here is continuity of existence and operations "during any lawful term" despite any change in beneficiaries. Clearly, then the trust instrument exhibits authority in the trustees to engage in business. * * *

The taxpayer's counsel concede the soundness of the *Porter* decision (Br. 5), but argue that the instant case is distinguishable because in the *Porter* case "there was no specific evidence of purpose" (Br. 38). It appears from the context that by this statement they apparently

mean that there was in the *Porter* case no source from which intention could be ascertained other than the "trust" documents. (Br. 32–38.) Counsel urge that an amendment of the "trust" instruments made September 30, 1938 (R. 70) and a stipulation as to Dr. Lombard's testimony concerning his intention [2] (Br. 34) be considered on this issue. The amendment was obviously not material in determining the purpose of the 1935 instrument in effect in 1937. Moreover, it would not be proper to consider it or Dr. Lombard's testimony as indicative of the purpose of the "trust" in 1937 as the Board properly refused to do on the authority of *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369. While it is not clear that counsel are correct in asserting that there was no evidence in the *Porter* case other than the "trust" instrument to ascertain the purpose of the arrangement, the following statement from this Court's opinion makes it clear that if there had been the Court would have refused to consider it (p. 279):

> The Supreme Court also said, in the *Morrissey* case, 296 U. S. at page 361, 56 S. Ct. at page 296, 80 L. Ed. 263, that the character of the enterprise was "determined by the terms of the trust instrument." In *Helvering* v. *Coleman-Gilbert Associates,* 296 U. S. 369, 373, 56 S. Ct. 285, 287, 80 L. Ed. 278, decided the same day as the *Morrissey* case, the Supreme Court expressed the thought as follows: "* * * Weight should be given to the purpose for which the

[2] Exhibit 2 (R. 15–19) is "Stipulation B". It states what Dr. Lombard would testify if permitted to over the Commissioner's objection. It is also stipulated that this exhibit was admitted in evidence at the hearing. (R. 3.)

> trust was organized, but that purpose is found in the agreement of the parties. Not only were they actually engaged, as the Board of Tax Appeals determined, in carrying on an extensive business for profit, but the terms of the trust instrument authorized a wide range of activities in the purchase, improvement and sale of properties in the cities and towns of the state. *The parties are not at liberty to say that their purpose was other or narrower than that which they formally set forth in the instrument under which their activities were conducted.* [Emphasis supplied by the Court.]

Counsel cite no authority for their proposition that the purpose of the trust may be ascertained apart from the trust instrument (Br. 32–38), but argue that *Helvering* v. *Coleman-Gilbert, supra,* is consistent with the interpretation that an oral agreement might be considered. They refer to the language of the Court that (p. 279) "Weight should be given to the purpose for which the trust was organized, but that purpose is found in the agreement of the parties", and argue that the Court did not insert "written" before agreement. (Br. 33.) But as this Court noted in the italicized portion of its opinion quoted above from the *Porter* case, the Supreme Court expressly stated in the same paragraph from which counsel quote that the purpose set forth in the *instrument* was conclusive. And, Article 1001–3 of Treasury Regulations 94 (Appendix, *infra*) states that "The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted." It is thus apparent that the Board was

correct in rejecting evidence of purpose other than as found in the "trust" instrument.

Applying the second test in the *Porter* case—the extent of the business activity—the Board concluded that the taxpayer's activities in the taxable year included the renting and managing of various business properties and growing oranges. (R. 71.) The Board stated (R. 71):

> From the limited facts on the point, it appears that petitioner is a business enterprise. It rents several properties and manages the buildings. The net annual rents, without considering depreciation, amount to $15,751.10. The properties include four "mercantile buildings", a store, and a service station with equipment. Petitioner grows oranges, which is certainly an agricultural and business enterprise. In this activity petitioner expended for "farm expenses" over $14,000. In 1937 the orange crop was sold for a gross amount of $24,635.

These findings are amply supported by the record. It appears from the gift tax return [3] filed by Dr. Lombard in 1935 that the following property was transferred to the "trust" during 1935 (R. 61):

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[3] It was stipulated that this return and the taxpayer's fiduciary return for 1937 were offered and received in evidence (R. 3), and the taxpayer designated the entire transcript to be printed as the record (R. 78–79). These returns were not, however, printed as a part of the record, but the Board's findings include the necessary information taken from them. The taxpayer apparently makes no objections to the accuracy of the Board's findings in this respect and this accuracy is readily verified by resort to the original record.

November 3, 1935, real property, Redlands	$5,610.00
November 19, 1935, real property, lot, Redlands	24,190.00
Novemger 19, 1935, real property, lot and building, Redlands	17,540.00
November 19, 1935, real property, lots	13,830.00
November 19, 1935, real property, lot and filling station Riverside	810.00
November 19, 1935, real property, 4 lots, San Diego	2,500.00
November 19, 1935, real property, orange grove, Redlands	2,000.00
December 31, 1935, stocks	64,587.93
	$131,067.93

It is to be assumed, since nothing appears to the contrary, that the "taxpayer" retained this property in 1937. The fiduciary return filed by the taxpayer in 1937 indicated income as follows (R. 62):

Dividends	$4,234.95
Interest on bank deposits	200.00
Rents—net—after repairs, depreciation and expenses	14,230.65
Receipts from orange grove—net—proceeds from sale of oranges	10,048.12
Total	$28,713.72

The fiduciary return showed deductions as follows (R. 62): Interest paid on a note for $39,000, $2,025.52; city and county property taxes, $155.92; state income tax, $137.50; social security tax, $14.94; miscellaneous expenses, $425.68; salaries, $2,904.84. Form 1040 F, "Schedule of Farm Income and Expenses" attached to the fiduciary return showed (R. 62) $24,634.95 from the sale of oranges and $494.66 from receipts from "water and pipeline"; total expenses of $15,081.49; net receipts of $10,048.12. The expenses of operating the orange grove includes wages, fertilizers and spraying materials, fuel, taxes, insurance, water rent, smudge oil, tractoring, telephone and repairs. (R. 62–63.) Apart from ranch products the sales made after March 14, 1937, were on March 24, 1937, when stock of American Trust Company costing $5,189.44 was sold for $5.145.35 and on

July 13, 1938, bonds of Kansas City School were sold for $5,520.75. On March 24 stock of Baltimore American Insurance Company was purchased for $5,133.75. (R. 64.) It is submitted that this evidence of business activity which includes extensive managing of property, operating an orange grove and, to a limited extent, buying and selling securities is sufficient business activity to warrant taxing the taxpayer as a corporation.[4] *Porter* v. *Commissioner, supra.* There, after finding in the identical instrument involved here a purpose to engage in business as noted *supra,* it was stated (p. 280):

> The activities of the trustees do not compel a contrary conclusion, but give rise to the conclusion that the activities during the taxable year were sufficent to constitute carrying on business. *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 171, 31 S. Ct. 342, 55 L. Ed. 389, Ann. Cas. 1912B, 1312; *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503, 514, 515, 37 S. Ct. 201, 61 L. Ed. 460; *Hecht* v. *Malley,* 265 U. S. 144, 161, 162, 44 S. Ct. 462,

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[4] Taxpayer complains (Br. 31):

> It does appear, however, that during the 4 years and 3 months that elapsed between March 14, 1937 and the hearing, the trustees made only two sales apart from ranch products, and sold only one small block of stock and one small block of bonds. [T. 15.] This is some evidence of inactivity and lack of profit purpose. It shows that the trustees were engaging only in the business of managing the properties received from Dr. Lombard. The Board fails to note such inactivity and its significance, while drawing an unwarranted inference from the fact that the trustees managed the property received from Dr. Lombard.

This contention would have merit if the only business were that of buying and selling securities. But it completely overlooks the ranching and real estate activities.

> 68 L. Ed. 949; *Thrash Lease Trust* v. *Commissioner,* 9 Cir., 99 F. 2d 925, 928. The activities here "went beyond transactions carried on for the single purpose of effecting a liquidation of assets; * * *." *Willis et al.* v. *Commissioner,* 9 Cir., 58 F. 2d 121, 123. Cf. *United States* v. *Rayburn,* 8 Cir., 91 F. 2d 162, 167, 168. Moreover, it is not alone what the trustees did during the taxable year, but what they were empowered to do. *Morrissey* v. *Commissioner,* 296 U. S. 344, 361, 56 S. Ct. 289, 80 L. Ed. 263; *Commissioner* v. *Vandegrift Realty & Investment Co.,* 9 Cir., 82 F. 2d 387, 390; *Sloan* v. *Commissioner,* 9 Cir., 63 F. 2d 666, 669, 670. Cf. *Helvering* v. *Washburn,* 8 Cir., 99 F. 2d 478, 481.

As pointed out *supra,* in addition to the business activities actually engaged in the taxpayer had the authority as in the *Porter* case to "own real estate or personal property in any State without limit, may buy, sell, improve, exchange, assign, convey and deliver, may grant trust deeds and may mortgage or otherwise encumber for obligations; may own stock in or entire charters of corporations, and may engage the Estate funds and properties in any industry or investment in their discretion, hoping thereby to make gain to the Estate." (R. 27–28.) It is no longer open to question that any activities which amount to more than a mere passive holding of property and a receipt of income therefrom are sufficient to constitute the carrying on of a business. *Morrissey* v. *Commissioner,* 296 U. S. 344; *Helvering* v. *Coleman-Gilbert, supra; Swanson* v. *Commissioner,* 296 U. S. 362; *Helvering* v. *Combs,* 296 U. S. 365; *Hecht* v. *Malley,* 265 U. S. 144; Treasury

Regulations 94, Art. 1001–2 and 1001–3. In the case at bar, the purposes in the formation of the "trust" as well as the activities carried on amounted to much more than mere protection, conservation, and distribution of property. Even where the trustees' sole functions in connection with the oil produced from the trust's oil leases were to collect, care for, and dispose of the oil, this Court held such activities constituted doing business for profit so that the trust was taxable as a corporation. *United States* v. *Trust No. B. I. 35, Etc.,* 107 F. 2d 22 (C. C. A. 9th), reversing 25 F. Supp. 608 (S. D. Cal.). And in *Marshall's Heirs* v. *Commissioner,* 111 F. 2d 935 (C. C. A. 3d), certiorari denied, 311 U. S. 658, it was held a sufficient business activity to constitute the trust an association taxable as a corporation where the trust was formed merely to manage property owned by four heirs and leased to others.

(b) The fact that expectancy fractions were registered in Dr. Lombard's name only prior to March 14, 1937, does not affect taxpayer's status as an association

Taxpayer's counsel argue that assuming the taxpayer was taxable as a corporation subsequent to March 14, 1937, it was not taxable as such prior to that time. They contend that since prior to March 14, 1937, Dr. Lombard was the sole beneficiary of the "trust" there were no "associates" and thus there was no association which could be taxed as a corporation. (Br. 5–15.)

The taxpayer was formed when Dr. and Mrs. Lombard, as grantors, executed the "Hulbert Plan Trust" naming Winthrop, Emily, and Norman Lombard as trustees (R. 55) and when Norman Lombard named

the owners of the "expectancy fractions" in a separate instrument (R. 59). He directed that Dr. Lombard be allocated 600 of a total of 1200 "expectancy fractions". Emily and Winthrop Lombard resigned as trustees and were succeeded by Dr. and Mrs. Lombard. Thus at the outset there were five individuals involved in the organization—two grantors and three trustees and no beneficiaries. The situation on the same day was changed so that there remained two grantors who, together with one other, were the trustees and in one of the grantors' names half of the expectancy fractions were issued; the other half "remain subject to the discretion of the Trustees." (R. 33.) At all times, therefore, there were at least three separate persons connected with the enterprise. If "associates" are necessary, were these three "associates" from January 1, 1937, to March 14, 1937? A clear answer in the affirmative is furnished by *Hecht* v. *Malley,* 265 U. S. 144, which modified *Crocker* v. *Malley,* 249 U. S. 223, and resulted in the final step in the logical development of the association doctrine taken in *Morrissey* v. *Commissioner, supra.* The Court, in holding a "Massachusetts Trust" an association taxable as a corporation, said, after defining "association" in its "ordinary meaning" as a "body of persons united without a charter, but upon the methods and forms used by incorporated bodies" (pp. 157, 161):

> We think that the word "association" as used in the Act clearly includes "Massachusetts Trusts" such as those herein involved, having quasi-corporate organizations under which they

> are engaged in carrying on business enterprises. * * *
>
> * * * * *
>
> We conclude, therefore, that when the nature of the three trusts here involved is considered, as the *petitioners are not merely trustees* for collecting funds and paying them over, *but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises,* the trusts are to be deemed associations within the meaning of the Act of 1918; * * *. [Italics supplied.]

This case has been cited with approval in almost all subsequent association cases and no case was found in which disapproval was shown either of its language or result.

Morrissey v. *Commissioner, supra,* extended to income tax the doctrine of the *Hecht* case which was concerned with a capital stock tax. There the Court said (p. 357):

> Thus a trust may be created as a *convenient method by which persons become associated* for dealings in * * * [the Court lists specific businesses] or other sorts of business; *where those who become beneficially interested, either by joining in the plan at the outset, or by later participation according to the terms of the arrangement, seek to share the advantages of a union of their interests in the common enterprise.* [Italics supplied.]

Thus, while it appears that in the *Morrissey* case the the Court speaks of the associates in terms of beneficiaries, it emphasizes that the entity is an association regardless of whether the beneficiaries come into the enterprise at the outset or come in later according to

the terms of the arrangement. See *Second Carey Trust* v. *Helvering,* 126 F. 2d 526, 528 (App. D. C.), certiorari denied, October 12, 1942. These cases describe precisely the situation in the case at bar as evidenced by the Board's findings that (R. 69):

> Dr. Lombard set about to obtain the consent of eight of the children to come into the plan. He did not obtain their consent at first and for that reason the entire 600 "issued" units of interests were registered in his name. The reregistrations of the 600 units to register interests in various children which were made on March 14, 1937, and February 26, 1938, were made pursuant to the consent of the eight children at or about such dates to come into the plan.

These findings are amply supported by the record. (R. 10–11, 15–19, 38–39, 40–41.)[5] Indeed, counsel concede that such was the situation (Br. 14):

> It may be conceded that at the time the trust declaration was executed in November, 1935, Dr. Lombard did intend or propose that *ultimately* the beneficial interest under the trust would be held by the members of his family and himself. * * *

[5] These findings are based partially on Stipulation B referred to in footnote 2, *supra*. Counsel object to the use of Dr. Lombard's testimony on the issue of the number of beneficiaries contemplated when the Board rejected it on the issue of purpose. As argued, *supra*, the Board was correct in so rejecting the extraneous evidence of purpose, but there appears no reason for excluding evidence relevant to a determination of who the intended beneficiaries were. In any event, as the record references indicate, and on the basis of counsel's concession, noted *supra*, the conclusion is supported by the provision of the "trust" instrument and what was done pursuant thereto without resort to Dr. Lombard's testimony.

Counsel's preoccupation with the number of beneficiaries goes to a question of form which the cases and the Regulations (Appendix, *infra*) have consistently stated is of no importance. *Morrissey* v. *Commissioner, supra*; *Commissioner* v. *Vandegrift Realty & Investment Co.,* 82 F. 2d 387 (C. C. A. 9th). This was properly recognized in *Porter* v. *Commissioner, supra,* when, as noted *supra,* this Court stated that the two tests of taxability as a corporation are (1) the purpose of the organization, and (2) the extent of its business activity. The Supreme Court in the *Morrissey* case gave some weight to the features of a trust that make it enough like a corporation when it is organized as, and carrying on, a business to require that it be taxed as a corporation. These features it described as follows (p. 359):

> What, then, are the salient features of a trust—when created and maintained as a medium for the carrying on of a business enterprise and sharing its gains—which may be regarded as making it analogous to a corporate organization? A corporation, as an entity, holds the title to the property embarked in the corporate undertaking. Trustees, as a continuing body with provision for succession, may afford a corresponding advantage during the existence of the trust. Corporate organization furnishes the opportunity for a centralized management through representatives of the members of the corporation. The designation of trustees, who are charged with the conduct of an enterprise, who act "in much the same manner as di-

> rectors," may provide a similar scheme, with corresponding effectiveness. Whether the trustees are named in the trust instrument with power to select successors, so as to constitute a self-perpetuating body, or are selected by, or with the advice of, those beneficially interested in the undertaking, centralization of management analogous to that of corporate activities may be achieved. An enterprise carried on by means of a trust may be secure from termination or interruption by the death of owners or beneficial interests and in this respect their interests are distinguished from those of partners and are akin to the interest of members of a corporation. And the trust type of organization facilitates, as does corporate organization, the transfer of beneficial interests without affecting the continuity of the enterprise, and also the introduction of large numbers of participants. The trust method also permits the limitation of the personal liability of participants to the property embarked in the undertaking.

The taxpayer has every corporate feature there designated. (1) Taxpayer holds legal and equitable title to the property. (R. 30.) (2) It has a continuing body of trustees with provisions for succession. (R. 25–26.) (3) It provides the opportunity of centralized management. (R. 20, 25–26, 27–28, 29, 30.) (4) The trustees are charged with the management of the enterprise. (R. 25.) (5) The trustees are named in the trust instrument. (R. 23–24.) (6) The death of beneficial owners does not terminate or interrupt the organization. (R. 33.) (7) Beneficial interests can be

transferred without affecting the continuity of the enterprise. (R. 39.) (8) Liability is limited. (R. 30-31.)

The "trust" instruments in at least seven separate paragraphs state that the legal and equitable interest in the property conveyed is in the trustees. (R. 20, 22, 24, 25, 30, 33.) It is commonplace that a trust is a device whereby legal interest in property is held by one or more persons for the benefit of one or more persons who have the equitable title. Restatement of the Law of Trusts, Sec. 2; Scott, The Nature of the Rights of the Cestui Que Trust, 17 Col. L. Rev. 269. Thus the Restatement states (p. 10):

> In a trust there is a separation of interest in the subject matter of the trust, the beneficiary having an equitable interest and the trustee having an interest which is normally a legal interest.

It may be noted that this is the rule in California (cf. *Title Ins. & Trust Co.* v. *Duffill,* 191 Cal. 629; *Keeney* v. *Bank of Italy,* 33 Cal. App. 515; cf. also California Annotations to the Restatement of the Law of Trusts, Sec. 2), although according to the Regulations, local law is of no importance in connection with this section. Regulations 94, Art. 1001–1 (Appendix, *infra*). It is likewise commonplace that the intention as expressed in the instrument must control the type of interests created. *Title Ins. & Trust Co.* v. *Duffill, supra.* It must be concluded that the taxpayer was more like a corporation than most ordinary business trusts which are taxed as corporations.

Unquestionably the purpose of Congress in taxing associations as corporations was to provide the same tax rate for entities which are not technically corporations but which carry on a business with all the advantages of the corporate form. Thus Article 1001–2 of Treasury Regulations 94 (Appendix, *infra*) states:

> The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an inter-insurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

Here is an organization which lacks only a charter to be a corporation, for corporations with but one stock-

holder are common.[6] Thus the corporation sole while not frequently observed still exists. Fletcher, Cyclopedia Corporations, Sec. 50, p. 184. And aggregate corporations organized and owned by one individual are common phenomena. Cf. for example, *Menihan* v. *Commissioner,* 79 F. 2d 304 (C. C. A. 2d); *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415; *Higgins* v. *Smith,* 308 U. S. 473; *Werner* v. *Hearst,* 177 N. Y. 63; *Louisville Gas & Electric Co.* v. *Moore,* 215 Ky. 273; *Button* v. *Hoffman,* 61 Wis. 20.

Since the purpose of taxing "associations" as corporations is to provide the same tax rate to organizations which do business with the advantages of the corporate form without being technically a corporation, the inquiry must be directed toward the concept "corporation" rather than "association." "Association" is merely a generic term under which all such noncorporate entities are grouped for convenience of definition. To approach the problem in the narrowly conceptualistic manner of the taxpayer is to invite incongruity and uneven application of the revenue act. Even if counsel's contention is sound that taxpayer is not technically an "association" because it lacks associates, it nevertheless cannot be denied that it is more like a corporation than most entities which have been classified as association and accordingly taxed as a corporation. Yet the test of taxability as a corporation is

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[6] It requires no citation of authority to establish that "Massachusetts Trusts" which Regulations 94, Article 1001-2 expressly provides are taxable as corporations need have only one beneficiary.

similarity to it. The incongruity can only be resolved by a pragmatic application of the association concept. That is the clear import of the statute, regulations and decisions.

Nor do counsel's authorities establish the contrary. His reliance on Section 19.3797 of Regulations 103 is misplaced. (Br. 10–11.) Regulations 94, Articles 1001–1, 1001–2 and 1001–3, were adopted pursuant to the Revenue Act of 1936 and are controlling here. When those articles (which are substantially like those relied upon by counsel) are read in their entirety rather than taking excerpts as counsel have done, it is clear that they support in all respects our contention here. The language which the taxpayer emphasizes comes from the section which is entitled "Trust Distinguished from Association." The section differentiates between a trust with more than one beneficiary and an association with more than one, probably because that is the more usual situation. Nowhere does the article make plurality of beneficiaries a *sine qua non* of association. Indeed, to do so would be utterly inconsistent with the admonition in Article 1001–1 that technical distinctions are of no importance and the tests of the regulations and cases which are business purpose and business activity. Counsel cite *McKean* v. *Scofield,* 108 F. 2d 764 (C. C. A. 5th); *U. S. Trust Co.* v. *Commissioner,* 296 U. S. 481; and *Magoon Trust Estate* v. *Commissioner,* decided July 10, 1942 (Prentice Hall B. T. A. Memo. Service, pars. 42,406, 43,406–A). These cases all involved the question of whether separate trusts with either common trustees or beneficiaries should be taxed as one

entity. They, therefore, obviously have no relation to the issue on which they were cited. It may be noted also that taxpayer's quotations from *Morrissey* v. *Commissioner, supra; Helvering* v. *Coleman-Gilbert, supra,* and *Cleveland Trust Co.* v. *Commissioner,* 115 F. 2d 481 (C. C. A. 6th) (Br. 9), while defining associations in terms of associates nowhere state that the beneficiaries rather than all the parties to the organization must be considered the associates.

(c) Section 166 of the Revenue Act of 1936 is not applicable here and the income of the taxpayer prior to March 14, 1937, was therefore not taxable to Dr. Lombard

The taxpayer's second major contention against its being taxed as a corporation from January 1, 1937, through March 14, 1937, even if it is taxable as such subsequent to March 14, is that under Section 166 of the Revenue Act of 1936 (Appendix, *infra*) the income during that period is taxable to Dr. Lombard as grantor. There is an insurmountable obstacle to this contention. Section 166 has no application to an entity which is classified as a corporation.

Under Sections 161 and 162 of the Revenue Act of 1936 the income of estates and trusts is required to be determined, with exceptions that are not material, as in the case of individuals and is made subject to the taxes imposed on individuals by Sections 11 and 12. Section 162 (b) and (c) allows deductions to trusts to the extent that income is to be distributed currently to the beneficiaries, or that income is properly paid or credited to them in the discretion of the trustees and requires the beneficiaries to report these amounts as income. Sections 166 and 167 provide that under cer-

tain circumstances the grantor may be taxed. Thus the statute taxes trust income at *individual rates* either to the grantor,[7] to the fiduciary (trust) or to the beneficiaries depending on the circumstances.

Under the Revenue Act of 1936 and the preceding acts, however, a corporation is allowed different credits and deductions than are allowed to individuals and is subjected to different taxes. Thus Section 13 of the Revenue Act of 1936 provides a relatively level graduated normal tax on corporations and an entirely new theory of taxation is embodied in Section 14 in the form of a steeply graduated surtax on undistributed profits of corporations. The normal tax on individuals (Sec. 11 of the Revenue Act of 1936) and the surtax on individuals (Sec. 12) provide an entirely different pattern. As established under (a) and (b) *supra,* whether the taxpayer is taxable as a corporation is made dependent solely on whether it is to be classified as a corporation. Section 1001 (2) of the Revenue Act of 1936. Once it is established that an entity is to be classified as a corporation it must be taxed under Sections 13 and 14, which are in terms applicable to "every corporation" (Sections 13 (b) and 14 (b)), and the provisions relating to trusts are no longer applicable. This is so obvious that it has long been taken

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[7] Regulations 94, Art. 166–1 provides: "If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor". It is therefore the unmistakable implication that taxation pursuant to Section 166 is at individual rates as is the case of Section 166 and the tax is levied pursuant to Sections 11 and 12.

for granted by the courts. The statute contains no exceptions under which a business trust may be taxed under Sections 162 or 166 rather than under Sections 13 and 14. The taxpayer's argument merely amounts to dressing up the point of view which is usually urged and rejected for taxing a business entity as a fiduciary under Section 162 and hence at individual rates under Section 11. For his argument resolves itself into contending that even though taxpayer is a business entity, individual rates should apply. The only refinement in this argument is the new twist—a revocable corporation! But income of business entities, whether or not "revocable" are taxed to the *organization* at corporate rates under Sections 13 and 14. No alternative is available.[8] Section 1001 (2) operates with the same effect to tax business-purpose trusts which are revocable and thereby excludes resort to Section 166 which is concerned with non-business trusts as it does in the case of non-revocable trusts to the exclusion of Section 162.

Thus the taxpayer was taxable at corporate rates thoughout 1937 because it was organized for business purposes and was engaged in business during the entire year. It was in form a corporation except for formal incorporation. It had "associates" but even if it did not it would be a distinction upon which no tax result turns. And finally, the income is not taxable to Dr. Lombard because Section 166 has no application to organizations taxable as corporations.

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[8] *Welch* v. *Bradley*, 130 F. 2d 109 (C. C. A. 1st), the only authority which taxpayer cites does not support its position since a traditional rather than a businesspurpose trust is involved.

CONCLUSION

The decision of the Board of Tax Appeals should be affirmed.

Respectfully submitted,

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JANUARY, 1943.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 161. IMPOSITION OF TAX.

(a) *Application of Tax.*—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income, which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and Payment.*—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor). For return made by beneficiary, see section 142.

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

*　　*　　*　　*　　*

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

*   *   *   *   *

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall

be included in computing the net income of the grantor.

*   *   *   *   *

SEC. 1001. DEFINITIONS.

(a) When used in this Act—

*   *   *   *   *

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

*   *   *   *   *

ART. 1001–1. *Classification of taxables.*—For the purpose of taxation the Act makes its own classification and prescribes its own standards of classification. Local law is of no importance in this connection. Thus a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See article 1001–3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See article 1001–4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See articles 1001–2 and 1001–4.) The definitions, terms, and classifications, as set forth in section 1001, shall have the same respective meaning and scope in these regulations.

ART. 1001–2. *Association.*—The term "association" is not used in the Act in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by

a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Act, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

ART. 1001-3. *Association distinguished from trust.*—The term "trust," as used in the Act, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a

declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a sumstitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature an dpurpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Act as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and cor-

porations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode or procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself. The Act disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enter-

prise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

U. S. GOVERNMENT PRINTING OFFICE: 1943

No. 10289.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

LOMBARD TRUSTEES, LTD., a Trust, and CHARLES S. LOMBARD, BERTHA M. LOMBARD and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

UPON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE UNITED STATES.

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SUBJECT INDEX.

TABLE OF AUTHORITIES CITED.

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PETITIONER'S REPLY BRIEF.

In his brief respondent contends

(a) The activities of the trustees established a business purpose;

(b) The trust should be taxed as a corporation prior to March 14, 1937, because "corporate forms" were employed or because of "resemblance" to a corporation;

(c) The trustees constituted the "association". (At least prior to March 14, 1937, the trustees were the association. Whether the trustees or the beneficiaries or all constituted the association thereafter is not discussed.)

(d) The purpose of the Lombard trust can be established only by the provisions of the trust declaration.

Business Activities.

Certainly the activities of the trustees in renting buildings and farming orchards received from Dr. Lombard constituted "doing business", as such term is frequently used. But such activities do not disclose a "business" purpose or require the trust to be classified as an association. The trustees did here exactly what the trustees of a pure trust would have done and exactly what the trustees did in 1939 after this trust was amended so that it followed "the form of a traditional trust." [T. 70.]

There are cases in which the activities of the trustees have evidentiary value in determining the purpose of the associates. Suppose several persons contributed funds or property to trustees in trust. If the trustees used the funds or property for a community hospital or a church, their activities would imply the trust was not for business purposes, but if the trustees used the funds or property for drilling an oil well, a different conclusion would be warranted. If a business purpose be shown in other ways, then the activities of the trustees here would justify classifying the trust as an association.

Resemblance to a Corporation.

It is high time the courts settled the misconception concerning the significance of "corporate form" and "resemblance to a corporation" in the case of a trust.

Every trust, whether classified for taxation as "traditional" or "association", has points of resemblance to a corporation. Every thing that the Supreme Court noted in *Morrissey v. Commissioner*, 296 U. S. 344, as "salient features . . . which may be regarded as making it

(a trust) analogous to a corporate organization" are found in traditional trusts, as the Supreme Court well recognized.

Congress provided for taxing trusts and also provided for taxing associations, which latter were grouped with corporations. What philosophy, theory or reasoning would justify classifying as an association rather than as a trust an organization that had been known as a trust for half a century? In the *Morrissey* case, the Supreme Court reasoned that as a trust had many features found in corporations, when one was "created and maintained as a medium for carrying on of a business enterprise and sharing its gains", Congress intended it to be classified as an association for taxation.

The test of whether a *trust* is to be classified as an association is not resemblance to a corporation or use of corporate forms. Nothing could result in greater confusion. The cases have established that a trust created and maintained for business purposes by a beneficially interested body of persons, will be held to be an association under every circumstance and regardless of whether or not (a) there are one or several trustees; (b) the beneficiaries select or control the trustees; (c) the beneficial interest be divided into shares or evidenced by certificates, or (d) the beneficial interests be transferable.

Whenever it appears the organization involved is in form a trust, it is a waste of words and energy to dwell upon the "corporate form".

At pages 26 and 27, respondent quotes at length the reasoning of the Supreme Court in the *Morrissey* case above referred to and then enumerates eight points of resemblance of the trust involved to a corporation. Each

of these points would also apply to the Lombard Trust after its amendment to the traditional trust form. After such amendment it could also be said (1) the trustees held the legal and equitable title; (2) the trustees constituted a continuing body with provisions for succession; (3) the trust provided opportunity of centralized management; (4) the trustees were charged with management of the enterprise; (5) the trustees were named in the trust instrument; (6) the death of the beneficial owners would not terminate or interrupt the organization; (7) beneficial interests could be transferred (by death) without affecting the continuity of the enterprise; and (8) liability was limited.

In *Porter v. Commissioner*, 130 Fed. (2d) 526, this court announced the tests for determining when a trust was to be held an association. This court did not include resemblance to a corporation. At no place in the *Porter* decision is there any reference to the resemblance theory.

This emphasis upon resemblance in the case of a *trust* is but an intellectual will-o'-the-wisp emanating from a mental morass.

The Trustees of a Business Trust Do Not Constitute an Association.

On page 23 of respondent's brief it is stated that *Hecht v. Malley*, 265 U. S. 144, furnishes a "clear answer" to the question whether the trustees of a business trust are the "associates." That is tantamount to saying *Hecht v. Malley* holds such trustees constitute the association. *Hecht v. Malley* holds nothing of the kind. It establishes the reverse.

That decision was concerned with excise taxes imposed by the revenue laws on "every corporation, joint-stock company or association." Involved were three Massachusetts trusts. Each had shares that were transferable. Each had trustees. Their general nature is shown by the following excerpts:

> "The Hecht Real Estate Trust was established by the members of the Hecht family upon real estate in Boston used for offices and business purposes, which they owned as tenants in common. It is primarily a family affair . . . The Haymarket Trust is strictly a business enterprise. It was established by the original subscribers, who furnished the money for the purchase of a building in Boston, used for store and office purposes. The shares are of the par value of $100 each . . . The Crocker, Burbank & Co. Ass'n is also a business enterprice. It was formerly entitled the Wachusett Realty Trust . . . Since the modification of the trust agreement, the trustees have carried on the manufacturing business in substantially the same manner as it was formerly conducted by the corporation . . . The trustees of Crocker Association . . . admitted in the circuit court of appeals and at the bar, that since the modification of the original trust agreement, the trust constitutes an 'asosciation.' "

The Supreme Court said:

> "The 'Massachusetts trust' is a form of business organization, common in that state, consisting essentially of an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed for the benefit of such persons as may, from time to time, be the holders of *transferable certificates* issued by

the trustees, showing the shares into which the beneficial interest in the property is divided. These certificates, which resemble certificates for shares of stock in a corporation, and are issued and transferred in like manner, entitle the holders to share ratably in the income of the property, and, upon termination of the trust, in the proceeds. . . .

"The word 'association' appears to be used in the act in its ordinary meaning. It has been defined as a term 'used throughout the United States to signify a body of persons united without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some common enterprise.' 1 Abbott's Law Dict. 101 (1897); 1 Bouvier's Law Dict. Rawle's 3d Rev. p. 269; 3 Am. & Eng. Enc. Law, 2d ed. 162; and Allen v. Stevens, 33 App. Div. 485, 54 N. Y. Supp. 8, 23, in which this definition was cited with approval as being in accord with the common understanding. Other definitions are: 'In the United States, as distinguished from a corporation, a body of persons organized for prosecution of some purpose, without a charter, but having the general form and mode of procedure of a corporation.' Webster's New Int. Dict. '(U. S.) An organized but unchartered body analogous to, but distinguished from a corporation.' (Cases omitted.)

"We think that the word 'association', as used in the act, clearly includes 'Massachusetts trusts' such as those herein involved, having *quasi* corporate organizations under which they are engaged in carrying on business enterprises. What other form of 'associations', if any, it includes, we need not, and do not, determine."

From the foregoing definitions it is apparent to constitute an association there must be an unincorporated

body of persons employing corporate forms. The trustees of a trust correspond to the directors of a corporation. Each provides management. Therefore, when an unincorporated group associated for business entrusts the management of their business to trustees they are employing the form most characteristic of a corporation. But the trustees as such do not constitute the "body of persons."

Relying on *Crocker v. Malley*, 249 U. S. 223, the trustees of two of the trusts contended in *Hecht v. Malley* "that they cannot be held to be 'associations' unless the trust agreements vest the shareholders with such control over the trustees as to constitute them more than strict trusts within the Massachusetts rule."

The Court then reviewed *Crocker v. Malley* in which it was held the trust there involved had the limited purpose of collecting and disbursing income and the beneficiaries had no right of control over the trustees. Under the Massachusetts law the trust involved in the *Crocker* case was a strict trust and the Supreme Court had held the trust was not a joint-stock association so as to make dividends received by the trustees taxable the second time as they would have been if received by a corporation.

The Court in *Hecht v. Malley* concluded the lack of control by beneficiaries would not prevent a trust from being classified as an association under the Act there involved when it was organized for business purposes. In emphasizing the distinction between a trust having a limited purpose such as to collect and pay over funds, as in the *Crocker* case, and one having a general business purpose, the Court referred to the trustees in the trusts there considered as being associated for the purpose of carrying on business enterprises.

Counsel for respondent seize upon the reference to the trustees being "associated" for carrying on business, and assert the Court said the trustees constituted the association. The Court had no such thought in mind. The entire paragraph from which counsel quote a few lines reads as follows:

> "We conclude, therefore, that when the nature of the three trusts here involved is considered, as the petitioners are not merely trustees for collecting funds and paying them over, but are *associated* together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises, the trusts are to be deemed associations within the meaning of the Act of 1918; this being true independently of the large measure of control exercised by the beneficiaries in the Hecht and Haymarket cases, which much exceeds that exercised by the beneficiaries under the Wachusett Trust. We do not believe that it was intended that organizations of this character—described as 'associations' by the Massachusetts statutes, and subject to duties and liabilities as such—should be exempt from the excise tax on the privilege of carrying on their business merely because such a slight measure of control may be vested in the beneficiaries that they might be deemed strict trusts within the rule established by the Massachusetts courts."

Both of these cases (*Crocker v. Malley* and *Hecht v. Malley*) are reviewed at length in *Morrissey v. Commissioner, supra.*

In the *Morrissey* case the Court repeats the definitions of an association given in *Hecht v. Malley,* which refer to an association as "a body of persons" and "an organized

but unchartered body." The Court adds emphasis to these definitions by stating " 'Association' implies *associates.* It implies the entering into a *joint* enterprise." Then the Court passes upon the facts presented in the *Morrissey* case where the beneficial interest was evidenced by 2,000 transferable shares held by several hundred persons. It says:

> "Thus those who took beneficial interests became shareholders in the common undertaking to be conducted for their profit according to the terms of the arrangement. They were not the less associated in that undertaking because the arrangement vested the management and control in the trustees. And the contemplated development of the tract of land held at the outset, even if other properties were not acquired, involved what was essentially a business enterprise."

The opinions in the *Morrissey* and three companion cases were handed down December 16, 1935. They were written by Chief Justice Hughes. He further disclosed his concept of an association by declaring in one of them (*Helvering v. Coleman-Gilbert Associates,* 296 U. S. 369): "A few persons, as well as many, may form an association to conduct a business *for their common profit.*"

The contention that the trustees may constitute an association was considered and rejected by the Supreme Court in *Crocker v. Malley, supra.* It also rejected the contention that the trustees and the beneficiaries constituted an association. It said,

> "the trustees by themselves cannot be a joint-stock association within the meaning of the act unless all trustees with discretionary powers are such . . .

We perceive no ground for grouping the two—beneficiaries and trustees—together in order to turn them into an association by uniting their contrasted functions and powers, although they are in no proper sense associated."

In *Hecht v. Malley,* the Court quoted the above and must have had it in mind in defining an association to be a body of persons united for the prosecution of some common enterprise. There can be no question but the Supreme Court in the *Hecht* case conceived the "body of persons" to be the beneficiaries and not the trustees.

Also, in the *Morrissey* case, the Supreme Court must have had in mind the question whether the trustees or the beneficiaries constitute the association, for it is declared the *Crocker* case decided:

"Nor could the trustees 'by themselves' be treated as a joint-stock association within the meaning of the Act 'unless all trustees with discretionary powers are such.'"

One of the most lucid expositions of the law bearing generally and specifically upon this case appears in the opinion of District Judge Tuttle in *Davidson v. U. S.,* Dec. 23, 1938, U. S. D. C., E. D. Mich., 24 Am. F. T. R. 118, affirmed 115 F. (2d) 799. Judge Tuttle said:

"The nearest approach to a general test appears to be the requirements that in order to constitute an association, taxable as such, there must be a number of persons (associates) entering into a joint enterprise for the transaction of business. The courts have emphasized the general points of resemblance between all trusts and all corporations, not as holding that all trusts are associations, but as explaining the

case with which the trust form can be used by associates in forming an enterprise for the transaction of business. and as justifying the subordination of form to substance in such cases. This Court is not convinced, however, that the mere points of resemblance referred to by the Supreme Court in Morrissey v. Commissioner, 296 U. S. 344, and strongly relied upon by the Government in this case, are to be considered as branding as an association, every trust in which those characteristics are found. If so, few or no trusts would be exempt. These characteristics were mentioned by the court in the Morrissey case as making a trust analogous to a corporate organization, and as justifying its taxation as such, if and when (but only if and when) these features common to both organizations have been used and adapted by persons joining in a common enterprise for the transaction of business."

Tax Statutes Cannot be Extended by Implication Beyond Their Clear Import and in Case of Doubt Are Construed Against the Government.

Considerable of respondent's argument appears bottomed on a contention there ought to be no distinction between a trust with one beneficiary and a trust of the same provisions with two or more beneficiaries.

Thus, respondent writes:

"Here is an organization which lacks only a charter to be a corporation, for corporations with but one stockholder are common . . . Even if counsel's contention is sound that taxpayer is not *technically* an 'association' because it lacks associates, it nevertheless cannot be denied that it is more like a corporation than most entities which have been classed as

> association and accordingly taxed as a corporation. Yet the test of taxability as a corporation is similarity to it. The incongruity can only be resolved by a pragmatic application of the association concept." (B. 29, 30, 31.)

The answer to respondent's contention is that Congress in its infinite wisdom has seen fit to provide otherwise. From the *Hecht v. Malley* decision in 1923 down to the present time, the courts have repeatedly declared that an association was, under the income tax law, "a *body of persons* united without a charter, but upon the methods and forms used by incorporated bodies for the prosecution of some *common* enterprise." Every definition and every decision has shown there must be a plurality of beneficiaries before there might be an association. All regulations have been harmonious. As Congress in the light of such definitions and regulations reenacted in every Act the provision "The term 'corporation' includes associations, joint-stock companies and insurance companies," it must have been satisfied with the concept of an association as declared by the courts.

Respondent would change the definition to read:

> "An association is a body of persons or a person who without being incorporated, uses the methods and forms of incorporated bodies for the prosecution of their or his business."

The result desired by respondent might be obtained only by extending the plain and accepted meaning of the term "association." That may not be done. In *United States v. Merriam,* 263 U. S. 179, 187, the Supreme Court said:

> "On behalf of the government it is urged that taxation is a practical matter, and concerns itself with

the substance of the thing upon which the tax is imposed, rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer. Gould v. Gould, 245 U. S. 151, 153, 62 L. Ed. 211, 213, 38 Sup. Ct. Rep. 53. The rule is stated by Lord Cairns in Partington v. Atty. Gen., L. R. 4 H. L. 100, 122.

"I am not at all sure that in a case of this kind —a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."

Evidence of Purpose.

In opening, we conceded that if the purpose of the Lombard Trust was formally set forth and appeared in the trust declaration, taxpayer was bound thereby and might not show a different purpose. We declared there was no formal or other statement of purpose in the trust declaration; that only inferences and conjectures might be drawn from the trust declaration and these were equivo-

cal; that the Board committed prejudicial error when it ruled it could not "go outside the terms of the agreement" and refused to consider all of the evidence. This presents a question that was not presented, considered or decided in the *Porter* case.

Respondent writes:

> "The Board's finding of a business purpose was based on the general purpose stated in the 'Plan', the broad powers given to the taxpayer and its business activities." (B. 15.)

Respondent does not call attention to provisions in the declaration revealing the "general purpose" nor have we been able to discover any. We are aware of provisions conferring broad powers upon the trustees but these are hardly broader than the powers conferred in most testamentary trusts. Among such *powers,* and so labeled, it is stated the trustees

> "may engage the Estate funds and properties in any industry or investment in their discretion, hoping thereby to make gain to the Estate." [T. 28.]

(We think trustees ought to be removed forthright if they invested the estate funds and properties hoping thereby to make a *loss* to the estate.)

In trusts there is as great a difference between purposes and powers as there is in nature between night and day. If powers are to be held equivalent to purposes in trusts, or if purposes are to be inferred or deduced from the powers conferred upon the trustees, then practically every testamentary trust must be held a business trust and taxed accordingly.

The provisions noted are appropriate for a business trust, but they would not be inappropriate for a strict

trust. If the declaration had stated that the trustees were to engage the funds for profit, or the purpose was to engage the funds for profit, these lines would not be written.

Courts have frequently repeated the dogma "the parties are not at liberty to say that their purpose was other or narrower than that which they formally set forth in the instrument under which their activities were conducted." After making the quoted statement, the courts have invariably proceeded to consider evidence dehors the declaration to ascertain the purpose of the trust. The Board did that. Respondent follows.

If the quoted declaration means what respondent contends, then the trust declaration here should be taken by its four corners and considered. If the only evidence of purpose which may be considered is that which appears there, then stop there. In so doing, it will appear that Dr. Lombard is the sole beneficiary.

When the respondent refers to Dr. Lombard's intention later to take in others, or to use the trust for the benefit of his family, respondent is definitely not applying the rule for which respondent argues. Respondent is then endeavoring to prove Dr. Lombard had a purpose that does not appear in the declaration.

Miscellaneous.

(a) *A beneficiary was provided for and named in the trust declaration.* In opening, we directed attention to the stipulation that the instructions directing expectancy fractions to be registered in Dr. Lombard's name was executed with the other instruments "as a part of and to evidence a single transaction and agreement." [T. 9.] We

said a beneficiary or *cestui que* trust was provided for and named in the trust declaration and the Board was mistaken in declaring the contrary. The Board's erroneous statement is repeated at page 6 of respondent's brief and on page 23 respondent writes, "Thus, at the outset there were five individuals involved in the organization—two grantors and three trustees and *no beneficiaries.*" We assume the plural form has been used advisedly. At the outset there were no beneficiaries but there was one beneficiary.

(b) *The beneficial interests were not fully transferable.* The only transfer referred to in the "Contract Containing Articles of Administration" is one in event of death of a beneficiary. [T. 33.] Standing alone, it may be doubted that provision would have prevented voluntary transfer. But in the instructions which were a part of the agreement, transfer is expressly restricted and, expressed in specific terms, no transfer could be made by a beneficiary other than Dr. Lombard without his "positive written instruction." [T. 39.] When respondent writes "Beneficial interests can be transferred without affecting the continuity of the enterprise" (B. 28, 29), respondent is correct, but one should not fall into the error of assuming the beneficial interests were freely transferable as are shares of a corporation. We think the question of transferability unimportant. If it be important, then it may be noted this trust has always lacked one of the most characteristic and distinguishing features of a corporation. Rather, in this particular, the trust is more like most testamentary trusts.

(c) *Title of the Trustees.* On page 28, respondent declares the trust instruments state the legal and equitable

interest is in the trustees. At no place do we find that statement. The trust declaration does declare that the legal and equitable *title* to the property held by the trustees is in the trustees. We think this phase unimportant. However, there may be a distinction between equitable interest and equitable title. The terms "equitable interest," "equitable estate," "beneficial interest" and "beneficial estate" are generally used as equivalent, and all have been applied to the interest of a beneficiary under a trust. In Restatement, the beneficiary is referred to as having an equitable *interest* in the subject matter of the trust. Such interest might also have been called the "beneficial *interest*." But equitable *title* is most commonly defined as a right in the party to whom it belongs to have the legal *title* transferred to him. (20 *C. J.* 1304.)

The beneficiary of an express trust, while having a beneficial interest in the subject matter of the trust, certainly does not ordinarily have any right to have the legal title conveyed to him. In the case of a resulting trust or constructive trust, it might with more exactness be said the beneficiary has an equitable *title*.

Title Insurance & Trust Co. v. Duffill (1923), 191 Cal. 629, referred to by respondent is merely one of numerous cases in which the interest of a beneficiary is referred to as the "equitable estate" or "beneficial interest." The California Supreme Court, in bank, in *Estate of Troy* (1931), 214 Cal. 53, said:

> "It may be taken as settled by the decisions in this state that the beneficiary of a trust takes no estate in the property itself and that title vests in the trustee with the right in the beneficiary to enforce performance of the trust."

Respondent appears to contend that the trustees here took a greater title than the trustees of a trust; therefore, says respondent, this cannot be a trust; rather, it is unclassified and unnamed thing unknown to the law that looks like a corporation but breathes and acts like a trust. But it is not a corporation. Then what is it? If Dr. Lombard's grantees did not take title for the benefit of another person or persons (thereby making a trust), they must have taken title absolutely, in the sense that the full beneficial interest and use was theirs. If so, they held the property as partners and were taxable as individuals.

(d) *Massachusetts Trusts.* In a foot note on page 30, respondent writes:

> "It requires no citation of authority to establish that 'Massachusetts Trusts', which Regulations 94, Article 1001-2 expressly provides are taxable as corporations, need have only one beneficiary."

We challenge that statement as promptly and as assuredly as a policeman would challenge a stranger climbing from a window with a child's piggy bank.

When two or more beneficially interested persons associate for business purposes, employing a trust form, and are engaged in such business, they constitute an association within the tax law. But when one beneficially interested person causes his property to be held and managed in trust form by another or others called "trustees," there is no association for tax purposes, and it cannot be made an association for tax purposes by pinning a label on it.

We think the term "Massachusetts Trust" does not have an exact meaning. If, however, the definition in

Hecht v. Malley be accepted, then the trust here involved was not a Massachusetts Trust as there were no transferable certificates.

(e) *Section 166 of 1936 Revenue Act.* We think respondent misunderstood us. Any trust is taxable as a corporation during any time it is legally an "association." If the trust in the instant case was not an association prior to March 14, 1937, then the trust is not to be taxed as a corporation on income prior to March 14, 1937. Rather, such income is taxable to Dr. Lombard under Section 166 of 1936 Revenue Act. It might further be added, it would also be taxable to Dr. Lombard under Section 167 of said Act.

(f) *Those Becoming Beneficiaries.* On page 24, respondent quotes from the *Morrissey* case the Court's remarks about those who subsequently become beneficiaries. Respondent says the Court "emphasizes that the entity is an association regardless of whether the beneficiaries come into the enterprise at the outset or come in later according to the terms of the arrangement." This doesn't deserve comment so none will be made except to remark that litigation, like war, frequently results in scarcity.

(g) *Changing Times.* In former days, reference was often made to the use of the trust for business to avoid corporation taxes. The adjusted income from the trust property for 1937 amounted to $22,902.04. At the rates in effect as this is written, the income tax on that amount at corporate rates would be $6,141.59 and at rates applicable to trusts, allowing the $100 trust deduction, would be $8,870.18. Times have changed. The courts should not be surprised in the new cases to find the positions of the parties have also changed.

(h) *Adjudication of All Questions.* If the Court holds the trust first became an association when others became beneficially interested with Dr. Lombard, it will be necessary to determine from what date in 1937 the income is includible, whether February 10, 1937 or March 14, 1937. After March 14, 1937, the sum of $1,868.96 was received as the balance of the purchase price of the orange crop sold on February 23, 1937. We contended Dr. Lombard might not relieve himself from returning and accounting for that item by transferring it. In his brief, respondent has not questioned or disputed our contention on these phases. However, should the case be returned to the Tax Court, respondent may resume his original position and claim the date of demarcation was February 10, 1937, and the year's income should be apportioned. The questions were fully presented to the Tax Court. It failed to decide them as it held there was an association from 1935 on. There should be a directive from this Court to the Tax Court on these questions in order to end the litigation.

Respectfully submitted,

GEO. W. HELLYER,
JOHN B. SURR,
Attorneys for Petitioner.

No. 10289.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

Lombard Trustees, Ltd., a Trust, and Charles S. Lombard, Bertha M. Lombard and Norman M. Lombard, Trustees thereof,

Petitioner,

vs.

Commissioner of Internal Revenue,

Respondent.

PETITION FOR REHEARING.

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Parker & Baird Company, Law Printers, Los Angeles

TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

Cases.

Statutes.

No. 10289.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

LOMBARD TRUSTEES, LTD., a Trust, and CHARLES S. LOMBARD, BERTHA M. LOMBARD and NORMAN M. LOMBARD, Trustees thereof,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING.

To the Court Above Named:

Petitioner respectfully requests a rehearing herein and a reconsideration of the single question discussed in the opinion filed May 21, 1943.

The trust involved was created November 3, 1935. Dr. Lombard contributed the property and was sole beneficiary until March 14, 1937, upon which date other members of his family acquired a part of the beneficial interest. In the opinion it was held the trust was an association during all of 1937. It would follow the trust was an association during all of 1936 and the part of 1935 elapsing after its creation.

No other court ever held a trust to be an association when there was a single beneficiary. The decision is of first impression and if it stands will have a far-reaching effect and probably be the most important decision handed down from this court in a decade.

There are innumerable trusts created by property owners for their sole benefit, wherein title to property is vested in a trustee or trustees to manage and handle generally. They are common. Since the decision was rendered, one came to our attention because of the death of a trustee. The owner of an orange grove and other property conveyed it to his brother and attorney, as trustees, to farm, handle, and manage generally, with broad powers of sale and investment, and to distribute the income to or upon the order of the grantor. This court says in the opinion that growing oranges is "certainly an agricultural and business enterprise." Therefore, that owner was engaged in business and he created and employed an organization in corporate form to take and hold this property and conduct a business for his benefit.

If the decision stands, the Treasury will certainly claim that the innumerable trusts of the nature of the trust last referred to are business trusts, taxable as associations. If this decision be correct, such other trusts are also associations. Any first impression decision upon an important point will, if correct, be extended and extended. Even if incorrect, it will be extended and do a world of damage until some court has the learning and courage to correct it.

We are not alone in our fears. C. C. Hogan, Esq., head of the trust department of Security-First National Bank of Los Angeles, writes:

> "After reading the brief and the decision of the Circuit Court of Appeals and discussing the matter in the office, we are impressed and frankly I am disturbed at the prospect of extending the application of what 'association' means under the income tax law to various similar trusts now being handled by trust companies where there is only a single beneficiary."

The decision declares that the only essential elements for an association are corporate form (which is found in every trust), a business purpose and engaging in business. It squarely holds the number of beneficiaries, whether one or plural, is unessential. In *A. A. Lewis & Company v. Commissioner,* 301 U. S. 384, 81 L. Ed. 1174 (decided May 17, 1937, more than two years after Morrissey), the United States Supreme Court declared the contrary. The facts of that case appear in the single syllabus which reads in full as follows:

> "A trust created by an owner of land with a view to its subdivision and sale, for the benefit of the grantor and of a real estate operator in whose hands the marketing of the property was placed and whose beneficial interest was limited to his commission upon the price for which lots should be sold, whereby the title was placed in a trustee whose duties were the merely ministerial duties of executing deeds at the direction of such real estate operator and the collec-

tion and distribution of payments after the initial payment, and who had no power to control, direct, or participate in the conduct of the selling enterprise, is not an association to be taxed as a corporation, within the meaning of Sec. 701 (a) (2) of the Revenue Act of May 29, 1928, 26 U. S. C., Sec. 2701."

There the question here under discussion was squarely presented and argued. The Commissioner claimed, as here, that one beneficiary was sufficient. The argument of counsel for the Commissioner on this point is summarized at page 1175 of 81 L. Ed. in the synopsis of the argument, as follows:

> "The trust cannot escape taxation as an association on the ground that there are but one trustee and one beneficiary."

There were two persons interested in that trust, one the owner and the other the real estate operator. The Supreme Court held the real estate operator was in effect the agent of the owner, and the relation was that of principal and agent. Hence, there was a single beneficiary. The Supreme Court concluded its decision as follows:

> "We are not able to find in the situation an 'association' within the meaning of the statute under consideration, *because there are no associates* and no feature 'making (the trust) analogous to a corporate organization'." (Our emphasis.)

It will be noted the Court rejected the contention that the trust was an association on two grounds, one that the trust was not analogous to a corporation; the other that it lacked associates. The first point turned upon the fact stated in the decision, "The duties of the trustee were purely ministerial, with no power to control, direct, or

participate in, the conduct of the selling enterprise contemplated by the contract." The first point would, today, be resolved upon the ground that the trust did not have a business purpose of a nature sufficient to cause it to be an association.

In the *Morrissey* case, the Supreme Court had said:

> " 'Association' implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business."

Now two years later, the Supreme Court squarely declares in the *Lewis* case that the term "association" as used in the statute will not be satisfied by a single beneficiary, or by a single beneficiary and his agent. As far as we are aware that was the last time the Treasury claimed, argued, held, or attempted to hold, that a trust of which the grantor was the sole beneficiary constituted an association until the instant case, when the contention was advanced for trading purposes by the technical staff in an endeavor to induce counsel for petitioner to accept February 10, 1937, as the date on which the association came into being—a date that no one on either side ever claimed was correct. Counsel in the technical staff fired a chance shot into the dark and appear to have brought down not only a bear but her entire family.

Not only is the decision, in all probability, the most important decision this court has rendered, but it is probably the briefest. Important facts are not stated. There is no discussion of the historical meaning of the term "association." There is no comment upon the numerous pronouncements of the Supreme Court and other courts defining the term and stating the elements

of an association. The opinion concerns itself only with incidental arguments, and the main argument and chief points are not referred to or answered.

The opinion discusses inconsequential facts such as "expectancy fractions." The next case and the case after that in which it will be sought to apply the rule of the decision will not have "expectancy fractions" and the reasoning on which the case has apparently turned will not be applicable. A first-impression decision should be reasoned and based upon broad principles that will be applicable in every case. If it cannot be so reasoned and based, it ought not to be rendered, for it is probably incorrect.

The decision stresses and appears bottomed on the ground that the trust here was in corporate form. "Corporate form" in the case of a trust is a red herring across the path of reason and is well calculated to lead astray, for both the strict trust and the business trust have resemblance to a corporation. During the development of the law on associations, there was much discussion of and concern about corporate form.

On March 2, 1936, less than three months after the decisions in the *Morrissey* and companion cases, this Court said in *Commissioner v. Vandegrift,* 82 F. (2d) 387:

> "There can hardly be a serious question as to the fact that the trust was carried on under a corporate form, but the Supreme Court indicates very clearly in Morrissey v. Commissioner, *supra,* that little consideration should be given to the form of organization under which the trust is operated."

By the time this Court reached *Porter v. Commissioner*, 130 F. (2d) 276, non-essential considerations had been thrown out of the window. This Court then said:

> "There are two tests to be applied to a trust in order to determine whether or not it is taxable as a corporation: (1) What is its purpose?; and (2) what is the extent of its business activity? Of the two, the first is the more important."

In the *Porter* case, nothing is said respecting corporate form. In the decision in the instant case, there is much said about corporate form. In the decision, the "corporate form" idea appears like the theme in a theme song. Three times the word "association" is followed by "corporate in form." And it is further written: "Petitioner, agreeing in our decision in the Porter case that the association is in corporate form, etc." In view of the fact the *Porter* case did not hold or intimate the trust there was in corporate form, or even discuss it, it may be doubted that petitioner agreed the trust was in corporate form. However, petitioner does agree the instrument and the organization in the *Porter* case and in the instant case were in "trust form," and if the expression "trust in form" were substituted for "corporate in form" where used in the opinion, there would be less likelihood of error.

The Treasury recognizes what has been said on the significance of "corporate form." In Regulation 94, Art. 1001-3 it is stated the result does not "depend upon technical arrangements or devices such as appointment or election of a president * * * the use of a 'seal,' the issuance of certificates to the beneficiaries * * * they are not essential * * * for the fundamental benefits * * *

are attained, in the case of a trust, by the use of the trust form *itself*." (Emphasis that of regulations.)

In our brief, we quoted the Supreme Court and other courts showing that in their conception more than one beneficiary was essential to constitute an association. Then we said "The foregoing statements are distinctly recognized by the regulations" and quoted the regulations. We did not quote or rely upon the regulations to prove the trust was an association, which would be an affirmative. We referred to them rather to establish a negative, namely, that a trust with one beneficiary did not meet the Treasury's own concept and definition of an association. We pointed to the fact the Treasury was careful to indicate the number of trustees was unimportant, whether one or more, but always referred to plural beneficiaries and we quoted from the regulations: "The nature and purpose of a *cooperative* undertaking will differentiate it from an ordinary trust * * * the beneficiaries are to be treated as voluntarily *joining or cooperating with each other* in the trust, just as do members of an association." The decision states "we regard the plural word 'beneficiaries' as inclusive of the singular." It is difficult to understand how it may properly be said a sole beneficiary is engaged in a "*cooperative* undertaking" or in what way a sole beneficiary can "be treated as voluntarily joining or cooperating with each other."

Generally, the regulations are as exact as language permits. They incline to be all inclusive rather than exclusive when inclusiveness is desired by the Treasury. They appear framed on the theory it is better to tax a dozen taxpayers who should not be taxed than to permit one who should be to escape. If the Treasury deemed that a trust with a sole beneficiary was an association, it

is amazing to note how very careless it was in this regulation. After employing the plural form of "trustees," the Treasury, out of its usual abundance of caution, inserted in parenthesis "(or a trustee)."

Now this Court states the Treasury intended the word "beneficiaries," as employed by it in the regulation, to include the singular, or in other words, the Treasury intended to state that a trust for business purposes with a single beneficiary was an association. We can't and don't believe it!

The opinion argues, "If petitioner's contention were correct, it could as well be argued that there could be no trust taxation where there is but a single *cestui*." The answer is, it could not be and would not be so argued. This regulation was for the purpose of aiding in determining when a trust is to be classified as an association and not when an association is to be classified as a trust. The term "trust" has a well established meaning. It was not necessary for the Treasury to issue any regulation as an aid to determining the number of beneficiaries required in the case of a trust and it has not purported to do so. Sections 166 and 167 of the Internal Revenue Code and the regulations thereunder mostly apply to trusts with a single beneficiary. The regulation in which we are interested was for the purpose of aiding in determining what characteristics in a trust would cause it to be classified as an association. From the constant use of the plural form accompanied by references to *cooperation* by beneficiaries, it certainly is proper to state the regulation recognizes that before a trust may be held an association there must be a plurality of beneficially interested persons. In any event, the regulation does not establish the affirmative, namely, that a trust with one

beneficiary is an association. The decision leaves the impression that the Court relies upon the regulation to establish that plural beneficiaries are not necessary for a trust to be an association.

In the next to the last paragraph of the opinion is the statement that holding all of the beneficial interest under the nomenclature of "expectancy fractions" is analogous to ownership of all the shares of a corporation. Whether the beneficial interest was given the fanciful name of "expectancy fractions" or the usual name of "beneficial interest" which, when held by more than one, is commonly expressed in fractions or percentages, has not the slightest significance. It may be said the holding of the entire beneficial interest in an association is, in a sense, analogous to ownership of all the shares of a corporation, but so is the ownership of the entire beneficial interest in a strict trust (if such be possible after this decision) equally analogous to the ownership of all the shares in a corporation.

The significance of the last two sentences in the paragraph of the opinion under comment is not clear. It is said "The fact that a stockholder owning all the shares of a corporation is also a member of its board of directors, as here the beneficiary was one of the trustees, does not make it any the less a corporation." The statement is true, but what is the relevancy? No one has claimed or would claim the fact that a sole shareholder was a director of the corporation dissolved the corporation, or caused the corporate veil to be pierced, although there are numerous cases where the corporation has been treated as a dummy. Nor are we aware that any one has claimed or would claim the fact that a sole beneficiary was one of the trustees, dissolved the trust, or pierced

the trust veil. Possibly the paragraph of the decision under comment is intended to convey the thought that as all of the stock of a corporation is sometimes held by one person, it should make no difference that all of the beneficial interest under a business trust was held by one person.

The argument should be addressed to Congress and not to the Courts. The sole question here is, what did Congress mean when it declared the term "corporation" included associations, joint-stock companies and insurance companies? Did it intend thereby to group with and tax as a corporation a trust of which the grantor was the sole beneficiary? Does such answer the concept of association? This case cannot be decided correctly without considering and determining the meaning of the term "association" as used in the statute. How can the definitions in the dictionaries and in the numerous cases be ignored? Either the various pronouncements of the Supreme Court and other courts were meaningless drivel, or the decision is erroneous.

In passing, it may be remarked any assumption that all of the stock of a corporation may be held by one shareholder is unwarranted. A corporation is always of statutory origin. Whether or not all shares of a given corporation may be held by one person depends upon the law of the state in which incorporated. Such would not have been possible in the case of a California corporation prior to 1929, and such is not now possible in the case of many corporations.

In the last paragraph of the opinion it is written:

> "Petitioner contends that it cannot be taxed as a corporation because the single beneficiary must in-

> clude in his gross income an amount equal to petitioner's income. This contention begs the question. Since petitioner is an association, corporate in form, it must be taxed under Sec. 1001 (a) (2) as a corporation. It makes no difference whether the sole beneficiary be taxed as a *cestui que* trust or a stockholder—an issue not here presented."

In our brief, as an incidental aid shedding some light indirectly upon the question under discussion, we stated the tax on the trust income before others became associated with Dr. Lombard, would fall on Dr. Lombard. That was also the initial contention of the Commissioner, only he used February 10, 1937, as the date others became associated, whereas, we deemed the correct date was March 14, 1937.

We wrote at page 19 of our reply brief, "Any trust is taxable as a corporation during any time it is legally an 'association.' If the trust in the instant case was not an association prior to March 14, 1937, then the trust is not to be taxed as a corporation on income prior to March 14, 1937. Rather, such income is taxable to Dr. Lombard under Section 166 of the 1936 Revenue Act." It seems to us the Court merely reiterates what we have stated and there is nothing to decide on this point and no question has been begged.

But the last sentence in the paragraph of the opinion above quoted is either irrelevant and has no place in the opinion or it is erroneous. Of course, there is no issue whether Dr. Lombard is taxed "as a *cestui que* trust or a stockholder" nor could there be one. The only question is, to whom is the income prior to March 14, 1937, taxable? If taxable to Dr. Lombard it is not taxable to the

trustees, and if taxable to the trustees it is not taxable to Dr. Lombard. Double taxation in such an instance would be unconstitutional.

This case can be correctly decided only by full consideration of the meaning of the term "association." Because of its importance it should be reheard.

Petitioner requests a rehearing.

Respectfully submitted,

Geo. W. Hellyer,
John B. Surr,
Attorneys for Petitioner.

Certificate of Counsel.

We hereby certify that in our judgment the foregoing petition for rehearing is well founded and we further certify that said petition is not interposed for delay.

Geo. W. Hellyer,
John B. Surr,
Counsel for Petitioner.